BOOKKEEPING and ACCOUNTING

McKINSEY

VOLUME I

SERIES A

BOOKKEEPING AND ACCOUNTING

By

Oscar

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PREFACE

The purpose of this text is to serve as a basis for an introductory course in bookkeeping and accounting and to provide a training which will serve the needs of three classes of students:

1. Those who desire to obtain employment in the accounting department of a business and wish an introductory training which will prepare them for such a position.
2. Those who do not desire to become bookkeepers or accountants, but who expect to enter business life and desire a knowledge of bookkeeping and accounting which will be of assistance to them in whatever line of business they may enter.
3. Those who expect to take courses in accounting in the university schools of commerce and desire a preliminary training which will serve as a basis for these courses.

It is undoubtedly true that only a small percentage of the students who complete an introductory course in accounting become bookkeepers. The larger part enter business occupations of various kinds, while an increasing number continue their studies of accounting and related subjects in the university schools of commerce before entering business life. This text has been designed especially to meet this situation. Bookkeping technique and routine have been eliminated to a considerable extent, especially in the early part of the text; and general principles have been emphasized with especial attention to those governing the interpretation and use of the information provided by the accounting records.

This text is distinctly different from other elementary texts on bookkeeping which seem to proceed with the assumption that their chief function is to train bookkeeping clerks and that as much technique as possible must be given at the beginning of the course; however, sufficient bookkeeping technique is given in connection

with both the text material and the laboratory exercises to train the student to do efficient work as a bookkeeper.

This text is based on the assumption that the primary function of the bookkeeping records is to provide information which may be used in the management of a business. This idea is emphasized both by the nature of the subject-matter and the method of its organization. This is well illustrated in the beginning chapter, which does not commence with a series of abstract definitions or a discussion of debit and credit, but with a simple explanation of the meaning and purpose of accounting which leads the student to see the nature and purpose of the things he is to study. In the next few chapters he is led to see that the function of accounting is to provide information with reference to assets, liabilities, proprietorship, income, and expense, and how this information may be presented in usable form by means of simple reports, such as the Balance Sheet and Statement of Profit and Loss. The accounts and books of original entry are then introduced as a means of providing the information necessary to make these reports. Debit and credit are explained quite logically and simply in connection with the construction and interpretation of the account.

Throughout the text the student is taught to analyze each transaction and to determine how its effect on the business will appear on the accounting reports before he attempts to make a record of it. He is taught to record the transaction in such a way as to describe its effect on the business instead of describing the transaction itself. In other words, he is taught to look at his records from the viewpoint of the manager and not from the viewpoint of the bookkeeper. This not only enables him to keep his records so that they will be more useful to the manager, but trains him so that he can advance to a managerial position.

The teacher will find considerable subject-matter in this text which is not ordinarily given in a first-year course in bookkeeping and accounting. Such subject-matter appears in every chapter, but some of the more important topics not ordinarily found in elementary texts are: turnover; calculation of percentages; graphical methods of presenting facts; comparative balance sheets; comparative statements of profit and loss; schedules, exhibits and analytical statements. The introduction of these topics is in harmony with the general plan of the text to teach the student the use of the information provided by the accounting records, as well as how to construct these records.

The text material is divided into distinct chapters, each chapter dealing with one principal topic. Each chapter consists of three parts:

1. A discussion of the accounting principles which relate to the topic of the chapter.

2. A series of questions and short problems for class discussion which develop and apply the principles discussed in the chapter. These questions are primarily "thought" questions which develop the student's ability to analyze and interpret business and accounting statistics.

3. Laboratory exercises and problems which illustrate and require the application of the principles discussed in the chapter. Although most of the laboratory material consists of short exercises which illustrate specific principles and minimize detail, sufficient "sets" running over a continuous period of two or more months are given to afford the student an acquaintance with the bookkeeping system as a whole. Business practice is optional with two of these sets.

It can be seen from the foregoing that the material is adapted to instruction by the class recitation method. It has been arranged so that class assignments can be made and recitations based on these assignments conducted.

This text is the outgrowth of the author's experience in teaching bookkeeping and accounting for several years in high school and university and much of the material included in the present volume has been used by him. The manuscript was used by him in the University of Chicago, in a summer session of the University of California, and in the University College of the University of Chicago for teachers of bookkeeping in the Chicago High Schools as a basis for a course on "Methods of Teaching Bookkeeping in Secondary Schools." The manuscript was also used by a number of high school teachers in their classes as a basis for an elementary course in bookkeeping. Many suggestions received, both from the teachers who used the manuscript in class work and those who have attended the classes of the author, have been incorporated in the text.

The author is indebted to many teachers, accountants and business men for helpful suggestions in connection with the preparation

of the manuscript. Among those to whom he is especially indebted are the following: Prof. L. C. Marshall and Prof. L. S. Lyon, his colleagues in the University of Chicago and A. L. Loring, of the State Normal School, Kalamazoo, Michigan, who have given many suggestions with reference to phraseology, methods of presentation, etc., H. F. Ford, director of the Commercial Department, High School, Orange, N. J.; W. C. Harvey, of Hibbard, Spencer, Bartlett & Co., and Prof. A. C. Hodge, of the University of Chicago, who assisted materially in the preparation of the laboratory set beginning with Chapter XXV; Mr. George E. Frazer, C. P. A., the author's partner, who, by means of our frequent discussions, has influenced the point of view which the text emphasizes.

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* Each Chapter is Followed by Questions for Class Discussion and Short Exercises for Laboratory Material. These are in Addition to the Laboratory Material in the Practice Sets

Bookkeeping and Accounting

CHAPTER I

MEANING AND PURPOSE OF ACCOUNTING

Meaning of Accounting

Business men have learned by experience that to manage a business successfully it is necessary to have information about the operations which the business performs or the things which the business does. The term "business" as here used includes all the activities by which individuals or groups of individuals seek to earn a livelihood. In this sense, the butcher, the grocer, the dry goods merchant, the lawyer, the physician, the druggist, are all "business men" and are engaged in the management of a "business." Each of these must have certain information, must know certain things about what he does day by day, in order to plan what to do in the future if he is to be successful.

The butcher must know how many pounds of meat of each kind he sells every day, in order to know how many pounds to have on hand to meet tomorrow's sales. The physician must know how many times he has called on each patient in order to know how much the patient owes him for his services. The dry goods merchant must know how much he has sold to each customer who purchased "on account" so that he may be able to collect the proper amount when it becomes due. The grocer must know how much he paid for the groceries he has purchased before he will know at what price to sell them. Each of the above, in all probability, will need information other than that mentioned, but the illustrations given are sufficient to indicate the necessity for some information in the management of every business, however small that business may be.

A business man may depend upon memory for a part or all of the information which he desires about his business. The butcher may remember from day to day the sales made and be able to judge therefrom the purchases which he should make. The grocer may

remember how much he paid for his groceries and make his selling prices accordingly. In a business of considerable size, however, it is impossible for the owner or manager to remember all he desires to know about his business.

If the physician calls on but ten patients, he may remember how many times he calls on each, but if he visits fifty patients he will find it necessary to make a record of each visit in order to be able to determine the amount which each patient owes him. If the grocer buys and sells numerous articles he will be unable to remember the cost of each and he will need a record of each purchase from which he can obtain this information. After he has sold the groceries, he will desire to know whether a profit has resulted from their sale and he can not remember all the facts which are necessary for him to determine this.

It will be seen, therefore, that certain information about the operations of a business is necessary if it is to be managed successfully. Since all the information necessary can not be remembered by the business man, he must devise some method by which to obtain it.

The method which he employs is to make a record of such information as he desires to keep. Through experience and practice certain ways and means have developed to record this information so as to make it most useful to the business man. There have developed ways also by which it may be prepared for his use in a classified and summarized form. These ways and means by which information about the operations of the business is recorded and prepared for the use of the business man are known as Accounting. It will be seen, therefore, that accounting means simply a method by which certain desired information about a business may be obtained.

The Nature of the Information Provided by Accounting

The nature and extent of the information which the accounting records provide will depend largely upon the nature of the business for which the records are kept. Accounting provides information about the *operations* of a business, that is, about the things which a business does. Businesses differ widely in the things which they do; consequently, the accounting records of different businesses will afford information of different kinds.

It is obvious that a butcher selling meat is doing a different thing than the man who is conducting a moving picture show. Consequently, the information provided by the accounting records of the

butcher will be different than the information provided by the accounting records of the moving picture owner. It has been suggested already that the physician desired to know the number of calls he made on each patient, the dry goods merchant the amount due from each customer, and the grocer the cost of goods purchased. Each desires information of a different kind and each may require a record peculiar to his own need to provide whatever part of this information he can not remember.

Since different business men desire information of different kinds, the question very naturally arises what determines the particular information which each desires. To understand this it is necessary to understand the purpose of the information which is desired; this in turn involves an understanding of the purpose of accounting, since it is by accounting that the information is obtained.

The Purpose of Accounting

It has been stated in a previous paragraph that it is necessary to have certain information about the operations of a business in order to manage the business *successfully*. It is obvious, of course, that the business man desires to manage his business so it will be successful. Granting this, there must be some means of testing or judging the success of a business. It is necessary to see, therefore, how the success of a business is determined. An illustration or two will make this apparent.

On January 1, 1920, James Arnold purchases a retail grocery store for $10,000.00 cash. He conducts this store for one year and sells it for $8,000.00. Assuming that the store was worth the purchase price and that he has not taken anything from the store in the way of groceries or cash for his personal use, it is easily seen that he has not managed it successfully. As a consequence of operating the store for one year he has $2,000.00 less than when he commenced. It is said, therefore, that he has made a *loss*, since he has less cash or property than in the beginning. If under the same conditions he had sold the store for $12,000.00, he would have increased his property or made a *profit* of $2,000.00. His management of the store would then be termed successful.

It may be seen, therefore, that *profit* is the test of the successful management of a business. The butcher, the grocer, the owner of the moving picture show, in fact all business men desire to manage their business so as to make a profit. They desire to have such information as will enable them to manage their business so a

profit will result. This information they obtain largely from their accounting records. It may be said, then, that the purpose of accounting is to provide information which will assist the business to be managed so that a profit may be made.

It is realized, of course, that others than those interested in the management of the business may desire to obtain information about it. If the owner desires to borrow some money from the bank, the officers of the bank may require him to give them certain facts about the business so they may judge whether he will be able to repay them at the time promised. The government may require a statement from him giving the amount of his income for the year so that the amount of his income tax can be determined. In a similar manner, others may desire information about his business. If he has kept his records so as to show him the information which he needs to manage his business properly, he can provide the facts which the outsiders wish. Therefore, it is the needs of the owner which should determine the nature of the accounting record.

There are some organizations which are not conducted for the purpose of making a profit, yet they need to use accounting. Public schools, churches, cities, etc., are illustrations. The present discussion, however, is concerned primarily with the use of accounting by business men, and business men are always seeking a profit. Its use by those organizations mentioned above can well be postponed until later.

The Accounting Method

Since the information desired in the management of different businesses is so varied, it readily may be realized that the number and form of the records used to obtain such information will be quite different. In explaining the meaning of accounting, however, it has been stated that accounting is a *method* by which information about a business is obtained. Although the *devices* in the way of forms and records which are used may vary greatly, the general plan or method employed in all cases is essentially the same. A simple illustration will indicate the nature of this accounting plan or method.

Bishop and Fairchild, two high school pupils, decide to run a "cab" between the city and the local fair grounds during the yearly fair which lasts two weeks. They agree that they both will assist in its operation and divide the profits equally. They further agree that they will determine their profit or loss at the end of the first week and it will depend upon the amount of the same whether or

not they will continue for the second week. They pay $5.00 a day rent for a car, with the agreement that they will provide all gasoline, oil, etc., required in operating the car and will repair all punctures, etc., which may occur. Fairchild collects all fares and at the end of each day the total amount collected is determined and recorded by each in a pocket memorandum. Bishop pays all expenses and each makes a memorandum of the amounts.

At the end of the week they desire to determine their profit. Consequently they obtain the total amount received from fares by adding the daily amounts recorded in their record. They classify their expenses and find the total amount spent for each purpose. They then determine their profits by a statement which will show the following results:

CASH RECEIVED FROM FARES:		
Monday	$10.00	
Tuesday	11.00	
Wednesday	12.00	
Thursday	13.50	
Friday	12.00	
Saturday	18.00	
Total Fares		$76.50
EXPENSES:		
Rent of Machine	$30.00	
Gasoline	10.00	
Oil	2.00	
Repairs	2.50	
Total Expenses		44.50
Profits for Week		$32.00

They decide, in view of the profits shown by this statement, to continue for the second week.

This simple illustration indicates quite well the method by which accounting records information and prepares it for use. It will be noticed that Bishop and Fairchild recorded certain facts day by day. Later they classified and summarized these facts and made a statement showing the results of the operations to which these facts pertained. After studying this statement they decided to continue the operations for another week. In every business, large or small, a

similar procedure is followed. Certain facts are recorded day by day; at the end of certain periods of time these facts are classified and summarized and made into a statement or statements so they can be understood and interpreted by the owner or manager. By a study of these statements, those responsible for the management of the business can determine the success of the business during the past and can plan its future management.

It is by the study of such statements or reports and the information which they contain that the owner or manager of a business is able to manage it successfully. It is the primary function of accounting, therefore, to prepare such reports and to provide the information which will make their preparation possible. It is the purpose of this text to explain the construction and use of such reports, the means of classifying and summarizing the information which they contain, and the method by which a day to day record is made of the information which is contained in the summarized records from which the reports are made.

Bookkeeping and Accounting

There is some difference of opinion concerning the distinction between bookkeeping and accounting. Frequently these terms are used, especially by those untrained in accounting, as more or less synonymous. As generally interpreted, however, bookkeeping refers to the mechanical routine involved in accounting. The making of the record is regarded as bookkeeping, while the planning of how the record is to be made and the presenting and interpreting of the information afforded by the record is considered accounting. The one who makes the record is termed a bookkeeper and the one who plans the record and prepares from it the accounting statements or reports, is termed an accountant. Sometimes there is a third person who verifies the work of the bookkeeper and accountant. This person is called an auditor.

In practice, the same person frequently does all or the major part of the work of both the bookkeeper and the accountant as described above. The bookkeeper must be able to interpret the records which he makes if he is to do efficient work. He must understand the purpose and function of the records he is using and be able to prepare reports which present in usable form the information which the records contain, otherwise he is not a bookkeeper, but merely a routine clerk. It will be seen from this that the bookkeeper should be able to do work which requires a knowledge of accounting. On

the other hand, the accountant is often called on to make records and thus is doing work of a bookkeeping nature.

It is quite difficult to state just where the work of the bookkeeper ends and that of the accountant begins. It is also difficult to make a clear distinction between bookkeeping and accounting. It is the purpose of this text to teach the student something more than the routine of bookkeeping. It purposes to give him the accounting principles which will enable him to perform bookkeeping work intelligently and to interpret and use the information which the bookkeeping records provide. As previously stated, it purposes to discuss the means and methods by which desired information about a business is obtained. Part of these means are of a bookkeeping nature and part are of an accounting nature as these terms are usually defined. For the sake of brevity and simplicity, "accounting" will be used in this text as the more comprehensive term, which includes all means and methods employed whether they be of a bookkeeping or of an accounting nature.

QUESTIONS FOR CLASS DISCUSSION

1

On the first of each month Robert King receives a statement from a local grocer stating that King owes him a certain amount for groceries purchased during the past month. The grocer sends such statements to a great many customers. How does he know how much each one owes him?

2

When King pays the amount due the grocer, he probably does so by giving him a written order which requests a local bank to pay the grocer the amount due. King will tell you that the bank will do this because he has "deposited" money at the bank previously. He makes frequent requests of the bank to pay money for him. How does he know that he has not asked the bank to pay out more money that he has deposited with it?

3

The bank receives frequent requests from King to pay money to people whom he owes. If it complies with all of these, how does it know that it has not paid out more money for him than he has deposited with it?

4

D. C. Brown owns two grocery stores in different parts of the same city. He says the location of No. 1 is "much better" than the location of No. 2. What does he mean by saying the location is "much better"? How does he know that it is?

5

King and Long both commence working on the same date as clerks in the store of James Arnold. They receive the same salary when they commence, but two years later King receives $25.00 a month more than Long. Arnold says he pays King $25.00 more than Long because he is "worth" that much more. What does he mean by saying he is "worth" more? How does he know?

6

If James Holt, a retail grocer, should decide to run a meat market in connection with the grocery business, what information will he need which he did not need previously?

7

A. M. Chapman conducts a grocery store for one year and then sells it. How would you determine the success with which he has operated the store during the year?

8

C. H. Dodge is the owner of a retail dry goods store. Who, other than Mr. Dodge, may desire to obtain information with reference to his business? How would they probably obtain this information?

9

Business men say they need accounting records in order to obtain information which will enable them to manage their business so they can make a profit. Give three illustrations of information which a business man would need and which he could obtain from a record that contained information in regard to the operations of his business.

10

L. R. Brown is employed by the International Wholesale Co. as a "bookkeeper"; J. A. Smith is employed as an "accountant" by the firm of Rudy & Allen, public accountants, and C. R. Jones is employed by the Rock Island Railway Co. as an "auditor." Explain in a general way the probable duties of each.

11

Business men say their accounting records aid them in making a profit. The government of a city is not operated for private profit. Will a city need accounting records? Why?

12

A. L. Bishop, who lives in New York, owns a store in Chicago which is in charge of M. D. Dodge. How can Mr. Bishop judge the efficiency of Mr. Dodge in managing the store?

13

There is a fair in your home town for one week and you and a friend decide to conduct a small "stand" selling ice cream, candy and cigars. You both work in the stand and have agreed to divide equally the profits made. You pay $10.00 to the Fair Association to get a location for your stand; the lumber which you use in fixing it costs you $15.00. During the week you purchase from local

merchants the goods needed and write the amount paid on a sheet of paper. Each night you count the money received from sales and write the amount on the same sheet of paper. All your goods are sold by the end of the sixth day. You sell the lumber used in the stand for $10.00.

How would you find your total purchases and your total sales at the end of the week? If the former are $200.00 and the latter $300.00, what would be your profit for the week?

14

Mr. Politician, who is a candidate for mayor of X city, states that the street railways of the city should not charge six cents a ride and if he becomes mayor he will see that a law is passed reducing the fare to five cents. The president of the street railways replies that a fare of five cents would not pay the expenses of running the railways. Mr. Politician replies that the president of the railways is not telling the truth. What would be necessary in order to judge who is right?

15

Explain as simply as possible the meaning of accounting. In the same manner explain the purpose of accounting.

LABORATORY MATERIAL

The following exercises are given for the purpose of illustrating and emphasizing the nature and importance of statements or reports. These exercises are to be prepared on loose sheets of paper:

Exercise No. 1

P. O. Rudy, a traveling salesman, sells goods on commission. During the week his daily earnings were as follows: Monday, \$9.80; Tuesday, \$10.50; Wednesday, \$16.40; Thursday, \$14.60; Friday, \$17.40; Saturday, \$5.20. His expenses during the week were as follows: Monday, \$2.60; Tuesday, \$6.20; Wednesday, \$3.30; Thursday, \$2.90; Friday, \$5.70; Saturday, \$3.20.

Make a statement similar to the illustration given on page 15, showing his net earnings for the week.

Exercise No. 2

James Miller is the proprietor of a hotel. During the first six months of the year of 1919 his receipts from meals and rooms are as follows: January, \$400.00; February, \$350.00; March, \$390.00; April, \$450.00; May, \$475.00; June, \$520.00. His expenses during the same months are as follows: January, \$310.00; February, \$380.00; March, \$290.00; April, \$350.00; May, \$360.00; June, \$400.00.

Make a statement which will show Mr. Miller the profit which he made during the six months.

Exercise No. 3

On January 1st, J. H. Allen purchases a grocery store for \$1,500.00 cash. During the next three months he makes the following sales for cash: January, \$450.00; February, \$400.00; March, \$500.00. During the same three months he pays cash for groceries purchased as follows: January, \$250.00; February, \$200.00; March, \$320.00. During the same three months he pays cash for expenses as follows: January, \$80.00; February, \$110.00; March, \$75.00. He sells the store on March 31st for \$1,200.00.

Make a statement showing the profit or loss resulting from the purchase, operation, and sale of the store.

Exercise No. 4

David Jones is treasurer of the Kingsville High School Athletic Association. During the scholastic year of 1919-1920, he receives cash from the following sources: dues from members of the association, $75.00; receipts from tickets to football games, $225.00; receipts from tickets to basketball games, $110.00; receipts from tickets to baseball games, $60.00. He makes the following payments: traveling expenses of football players, $80.00; expenses of visiting football teams, $90.00; cost of football equipment, $50.00; traveling expenses of basketball players, $40.00; expenses of visiting basketball teams, $35.00; cost of basketball equipment, $15.00; traveling expenses of baseball team, $55.00; expenses of visiting baseball teams, $25.00; cost of baseball equipment, $20.00; miscellaneous expenses, $30.00.

Make a statement such as Jones might submit to the Association showing cash receipts, cash disbursements and balance of cash on hand. (See illustration on page 15.)

Exercise No. 5

Assuming that the receipts from membership dues and the miscellaneous expenses in Exercise No. 4 are to be divided equally among football, basketball, and baseball, make a statement showing the results of the season with reference to each kind of athletics.

CHAPTER II

ASSETS, LIABILITIES AND PROPRIETORSHIP

The Basis of Business Management

In the preceding chapter it has been explained that accounting is a means or method by which certain information is obtained about a business. It has been explained also that this information is desired in order that it may be used in managing the business so that a profit may be made. The owner of a business is the one who directly or indirectly exercises control of the business. It is necessary, therefore, for accounting to give the owner the information which he needs. In order to understand how accounting may do this, it is necessary to see what information he should have.

The information which the owner of a business needs in order to manage it so that a profit shall result, may be classified as follows:

> 1. Information about the property employed in the conduct of the business; that is, about the things which the owner uses in the carrying on of the business, such as cash, merchandise, furniture, fixtures, etc.
>
> 2. Information about the operations he performs; that is, about the things which he does, such as the buying and selling of merchandise, and the paying of expenses.

The owner of a business expects, therefore, that his accounting records will provide information which will make possible the preparation, at the end of certain periods of time, two statements or reports. The first shows him the nature and value of the property which he is using in the business. The second shows him the operations which the business has performed; that is, the things which it has done during the period, and the result of these operations. The purpose of both of these reports is the same,—to give the owner information which will enable him to manage his business so as to make a profit, and as large a profit as possible. The first report shows the owner the property which he has available for use in his business. The second report shows him the results of its

use during the past period, and from these results he can judge the best way to use it during the coming period. It can be seen, therefore, that these reports serve as the basis of management by the owner.

It will be the purpose of the next few chapters to discuss the information which should be shown on these reports or statements and to show how the accounting records may be used as a means to obtain this information. In later chapters other reports which are needed in managing a business will be discussed.

Assets and Liabilities

The property which the owner uses in the conduct of his business is known in accounting as Assets. An asset may be defined as any property which an owner uses or employs in the conduct of his business. The merchandise, desks, counters and showcases used in the conduct of a mercantile business are examples of assets.

In a business of considerable size the owner does not himself own all the property which he needs in the conduct of his business, hence he must obtain some property from others. This he does in an indirect way either by borrowing money to purchase the property which he needs or by purchasing it "on account," that is, he does not pay for it immediately. As a consequence, he becomes indebted to others or he incurs what is known in accounting as a Liability. A liability may be defined briefly as a claim upon the assets of a business. It is spoken of as a claim upon the assets, for sooner or later some of the assets, usually in the form of cash, must be given in payment of the liability to the one to whom the liability is incurred. If Robert Long, a retail grocer, purchases groceries for which he promises to pay in thirty days, he incurs a liability, for those from whom he purchases them have a claim upon his assets until he pays for the goods.

Proprietorship

The owner in estimating the true worth of his property or assets invested in the business must always take into consideration the liabilities which are claims against these assets. If Robert Long, a retail grocer, employs in the conduct of his grocery store cash to the amount of $1,500.00, merchandise to the amount of $3,600.00, showcases, counters, and store furniture worth $500.00, and equipment used in delivering goods to customers worth $400.00, he is

using a total of $6,000.00 of assets in his business. If, however, he has borrowed $1,000.00 from his local bank, he must take this amount into consideration when he is thinking about his business. His net assets, or the amount which he would have after paying his liabilities, are only $5,000.00. This $5,000.00, or the difference between his assets and his liabilities, is known in accounting as his net worth or Proprietorship. It represents the interest of the owner in the business. It is necessary to notice a little more in detail the nature of proprietorship.

The Nature of Proprietorship

As defined above, proprietorship, which is the difference between the assets and liabilities of a business, represents the interest of the owner in his business. It is quite evident that the owner desires to increase his interest as much as possible, for if this item increases it indicates that the owner has a right to a larger share of the property invested in the business than he had originally. This increase in his interest or share may be withdrawn from the business, or it may be used in the further conduct of the business in an endeavor to increase his interest still more.

In the illustration given under the discussion of proprietorship, Robert Long is using $6,000.00 worth of property in the operating of his grocery store. Others have a claim against this property for $1,000.00; therefore his interest or ownership in the business amounts to $5,000.00. If a year later the total property invested in the business amounts to $8,000.00 and his liabilities amount to $2,000.00, he has an interest in the business of $6,000.00, or $1,000.00 more than at the beginning of the year. He may withdraw this $1,000.00 from the business and the business will be in the same condition as at the beginning of the year; or he may decide to leave it in the business, hoping by the use of the additional $1,000.00 worth of property to increase his proprietorship during the coming year more than during the past year.

In any case it is obvious that the primary object of his continuing the business is to increase his net investment or proprietorship. It will be realized, therefore, that accounting should provide the owner with information about his business which will enable him to manage it so his proprietorship will be increased and it should also give him information which will show him if such an increase has been secured.

Ascertainment of Proprietorship

The amount of the owner's interest or his proprietorship, as previously explained, can be obtained at any time by subtracting the total amount of his liabilities from the total amount of his assets. To illustrate: If the assets of James Madison, a retail merchant, consist of cash, \$252.00; debts due from customers to whom merchandise has been sold "on account," \$484.01; merchandise on hand, \$1,450.00; furniture and fixtures, \$220.00; and delivery equipment, \$400.00; his total assets would be the sum of these, that is, \$2,806.01. If he owes creditors from whom he has purchased merchandise, \$765.85, his liabilities are \$765.85 and his net worth or proprietorship is \$2,040.16.

The assets, liabilities, and proprietorship of Madison may be shown by the following statement:

ASSETS:		
Cash	\$ 252.00	
Debts Due from Customers . . .	484.01	
Merchandise on Hand	1,450.00	
Furniture and Fixtures	220.00	
Delivery Equipment	400.00	
Total Assets		\$2,806.01
LIABILITIES:		
Debts Owed to Creditors . . .		765.85
Net Worth or Proprietorship		\$2,040.16

Such a statement as the above shows the owner the amount and kind of his assets, the amount and kind of his liabilities, and the difference between the two, or his proprietorship. By a study of this statement he can see whether or not the property which he originally invested in the business has been preserved and maintained. What is of equal importance, it gives him information about his assets and liabilities which will assist him in planning how to use and control them so as to increase his proprietorship. This statement, then, furnishes the owner very important information, since it not only shows him his present financial condition, but also serves, in connection with other statements to be discussed later, as a basis of future plans. One of the primary aims of accounting, therefore, is to provide information which will make possible such a statement showing assets, liabilities, and proprietorship.

Form of Proprietorship

In the illustration used in the foregoing discussion James Madison is the sole owner of a retail store, so in ascertaining his proprietorship it is only necessary to subtract total liabilities from total assets and show the difference as his interest in the business. If the business continues to grow, Madison may make an agreement with one or more persons by which they are to invest certain assets in the business, assist in its management, and in return receive a share of its profits or in case of loss bear their proportional share. A business conducted under such an agreement is known as a partnership. The amount of the proprietorship of such a business is obtained in the same manner as in the case of the sole proprietorship by subtracting total liabilities from total assets. The only difference in the construction of the statement which is made to show proprietorship is that in the latter case the proportionate interest of each partner in the partnership should be indicated.

In many cases the proprietorship is not vested in a sole proprietor or a partnership, but in a corporation which is an association of individuals engaged in business under the authority of a charter or written permission granted by governmental authority after compliance with certain legal requirements. So far as the statement of the assets and liabilities by means of a report is concerned, it makes no difference whether the business is conducted as a sole proprietorship, a partnership, or a corporation. The only difference is in the method of showing the proprietorship. In future chapters the nature of the partnership and the corporation will be explained and reports in connection with them discussed. For the present, the discussion will relate to the sole proprietorship, that is, a business owned by one person.

Summary

The fact of primary importance for the student to bear in mind at the present time is that the most important aim of accounting is to provide information which can be used by those in charge of the management of the business to increase the proprietorship interest, whether that interest is vested in an individual, a partnership, or a corporation. It is also important for the student to understand that the purpose of such a report as that discussed above is to present such information in a form which makes it readily understandable and usable on the part of the management. It will be the purpose of the following chapter to discuss more in detail the construction and interpretation of this statement of assets and liabilities which in accounting is called a Balance Sheet.

QUESTIONS FOR CLASS DISCUSSION

1

If you should inherit a building from a deceased relative and leave it unused for several years, what would probably happen to it?

2

Instead of leaving it unused, what would you do with it?

3

You rent the building for $500.00 a year. At the end of 15 years it is necessary to replace it with a new building which costs $5,000.00. John Smith, who owns a building similar to yours, leaves it unoccupied for 25 years and is then ordered by the city to tear it down because it is regarded as dangerous. Which of the two, you or Smith, has followed the wiser course? How would you prove it?

4

If you inherited $5,000.00 in addition to the building mentioned in No. 1 and you knew something about the grocery business, what might you do instead of renting it?

5

If you found later that you needed $2,000.00 more in order to conduct your business properly what might you do?

6

If at the end of three years you wish to determine whether or not it has "paid" to conduct a grocery store yourself instead of renting the building, what would you have to know? How would you obtain this information?

7

In accounting, what is property called, such as buildings, delivery equipment, furniture, etc., which is used in conducting a business? If others besides the owner have claims on the property of the business, what are these claims called?

8

How is the proprietorship of a business determined? Why is it important to know the amount of the proprietorship?

9

Name five assets which would usually be employed in the operation of a grocery store? Name two liabilities which such a store might have?

10

The assets of J. B. Moseley on December 31, 1919, are \$8,000.00 and his liabilities on the same date are \$3,000.00. What is the net worth or proprietorship of Moseley?

11

If one year later the assets of Moseley have increased \$2,000.00 and his liabilities have increased \$1,000.00, what will be the effect on his proprietorship?

12

Will he regard this change in proprietorship desirable or undesirable?

13

What may he do with this increase in his proprietorship?

14

In planning his business for the next year, what information will he expect to obtain from his accounting records?

15

Will he obtain this information by examining the records or can he obtain it in some other form?

LABORATORY MATERIAL

The following exercises are given to illustrate and develop statements or reports showing net proprietorship. These exercises are to be prepared on loose sheets of paper:

Exercise No. 6

From the records of Joseph Warner, retail merchant, the following list of miscellaneous items is copied on January 1, 1919:

1. Office Equipment	$ 500.00
2. Delivery Equipment	400.00
3. Owed to J. W. Baker	300.00
4. Due from A. B. Hill	75.00
5. Owed to R. S. King	400.00
6. Due from O. P. Lease	80.00
7. Due from C. R. Anderson	70.00
8. Due from J. T. Hensley	60.00
9. Owed to W. B. Hall	300.00
10. Merchandise on Hand	1,500.00
11. Due from O. T. Hines	100.00
12. Cash	600.00
13. Due from J. T. Alward	50.00
14. Owed to M. M. McGee	40.00

Instructions: On a sheet of paper ruled similar to Illustration No. 1 (page 38) write "Assets" at the top of the left-hand money column and "Liabilities" at the top of the right-hand money column. Write the above items on this sheet and list the amounts so as to show which are assets and which are liabilities.

Exercise No. 7

Arranging the assets and liabilities of Warner according to the illustration given on page 26 determine his net worth or proprietorship.

Exercise No. 8

On December 31, 1919, the cash of Warner has increased $150.00; the debts due from customers have increased $400.00; his office equipment has decreased in value $50.00; his delivery equipment has decreased in value $40.00; his merchandise on hand has increased $150.00; and he owes to creditors $200.00 more than at the beginning of the year.

Make a statement in the same form as in Exercise No. 7 to show the proprietorship of Warner on December 31, 1919.

Has Warner made a profit or a loss during the year?

Exercise No. 9

J. B. Long, a farmer, has the following assets:

Cash	$ 250.00
Horses	750.00
Cattle and Hogs	1,500.00
Grain and Feed	2,280.00
Farm Machinery	1,980.00
Farm Land and Buildings	8,750.00

He owes local merchants $85.00 and owes his local bank $1,200.00. Make a statement (see page 26) showing the net worth of Long.

Exercise No. 10

A. K. Johnson, a Certified Public Accountant,* has the following assets:

Cash	$400.00
Due from Clients	500.00
Office Furniture	800.00
Stationery and Supplies	200.00
Professional Books	700.00

He owes the following:

Western Electric Co.	$10.00
City Stationery Co.	15.00
City Water Co.	5.00

Make a statement showing his proprietorship.

* If the student does not know the meaning of "Certified Public Accountant," he should ask the instructor to explain.

CHAPTER III

THE BALANCE SHEET

Purpose of the Balance Sheet

The Balance Sheet of a business shows the nature and amount of its assets, the nature and amount of its liabilities, and the difference between its assets and liabilities, or its proprietorship. From the viewpoint of the owner or manager this information serves two important purposes:

> 1. It enables him to see if his original investment has been maintained and if any additions have been made thereto. This helps him to judge past results.
>
> 2. It enables him to plan how to use his assets and control his liabilities in the future so as to increase his proprietorship. This helps him to plan and control future results.

Although the primary function of the Balance Sheet is to give information which will serve the two purposes mentioned above, the student will realize that it may serve other purposes. In the discussion of the purpose of accounting in a previous chapter, it was stated that its chief purpose was to provide the owner with the information which he needed in the conduct of his business; likewise that others besides the owner are sometimes interested in the business, and accounting also serves to give them the information which they desire. As illustrations of such interested parties, bankers from whom the owner desires to borrow money, and the state which wishes to know how much to tax the owner, are mentioned.

The Balance Sheet is one of the means by which the information provided by accounting is presented to those who desire it. The student will realize, therefore, that although its chief purpose is to serve the need of the owner, it is also its purpose to give other interested parties, such as those mentioned, the information which they desire. However, if it is made so as to give the owner the information which he needs in the conduct of his business, all others can usually obtain the information which they desire. It is, therefore, as a report to the owner that the Balance Sheet will be considered for the present.

The Form of the Balance Sheet

Since the purpose of the Balance Sheet is to give the owner the information which he needs to manage his business, it should be in the form which gives this information the most readily. The Balance Sheet shows three main items: assets, liabilities, and proprietorship. The simplest form of a Balance Sheet would be one which shows these in total.

If the total assets of James Madison are $2,806.01, his total liabilities $765.85, and his proprietorship $2,040.16, his Balance Sheet might be made in the following form:

Assets	$2,806.01
Liabilities	765.85
Proprietorship	$2,040.16

Such a statement would give Madison information of some value, for by comparing it with previous statements he could see whether his proprietorship had decreased or increased and thereby judge of the success of his business in terms of profit and loss. He wants more information than this, however, for he desires to know the nature of his assets and liabilities as well as their amount; hence it is necessary to show the assets and liabilities as several items and not as totals only. In Chapter II it is suggested that James Madison might ascertain his proprietorship by listing his assets and liabilities as follows:

ASSETS:		
Cash	$ 252.00	
Debts Due from Customers . . .	484.01	
Merchandise on Hand	1,450.00	
Furniture and Fixtures	220.00	
Delivery Equipment	400.00	
Total Assets		$2,806.01
LIABILITIES:		
Debts Owed to Creditors		765.85
Proprietorship		$2,040.16

Such a statement as this gives the owner much information which he can not obtain from a Balance Sheet showing only *total* assets and *total* liabilities. By studying this statement he can see the different kinds of property he has and the nature of his liabilities and so is better able to judge the success of his past operations and to plan his future business.

In listing the items on the preceding page, the terms employed in designating the particular assets and liabilities are those which might be used by a person who is unfamiliar with the generally accepted terminology of accounting. However, there is a certain mass of terminology which is rather generally accepted by accountants, especially as applied to the more common kinds of assets and liabilities. Since these accounting terms are used almost universally, it is necessary for the student to become familiar with them. In order to explain the use and meaning of these terms, it is deemed desirable to discuss separately some of the items appearing in the statement on the preceding page.

Debts Due from Customers

These debts consist of promises to pay which customers have given in exchange for merchandise. These promises may be written or they may be oral. If a customer gives his written promise to pay for merchandise, this promise is called a note receivable.* If he gives an oral promise under the same circumstances, it is termed an account receivable. It is customary, therefore, to list on the Balance Sheet the amount due from customers under these two headings.

In the illustration on the preceding page, there is listed as due from customers $484.01. In a retail store, such as that of James Madison, it would be quite unusual for written promises to be received in payment of merchandise. Probably the only conditions under which such written promises would be received would be when a customer failed to pay his oral promise at the specified time and gave a written promise in order to obtain an extension of time. Such customers would be regarded as undesirable and, therefore, a large item of notes receivable on the Balance Sheet would be looked upon with suspicion. If it is assumed that in the case of James Madison he has written promises to the amount of $27.92 and oral promises to the amount of $456.09, these debts of his customers would be listed on his Balance Sheet as follows:

Notes Receivable	$ 27.92
Accounts Receivable	456.09

Although usually few written promises or notes, as they are called by business men and accountants, are received by retail stores, in some other lines of business it is quite customary to receive written promises to pay for goods. Consequently a large item

* It is, of course, realized that a written promise might be made which would not be a note because lacking the essentials of a note. Such instances are so rare it is thought unnecessary to make this distinction here.

of notes receivable on the Balance Sheet of such businesses would not be regarded as unfavorable. This will be discussed more fully in subsequent chapters.

The student should not bother about the nature and form of the written promises discussed above. These will be discussed and illustrated later. It is sufficient for him to know at present that such written promises are used in the conduct of business and that they are called notes receivable when in favor of the business and constitute an asset of the business.

The oral promises to pay, which are received from customers, are shown on the Balance Sheet as a total. In the accounting records the amount due from each customer is shown. It is not desirable, however, to show on the Balance Sheet the name of each customer who owes the business, so only the total is given. Sometimes a list of the customers and the amount each owes is attached to the Balance Sheet. A list of the customers of James Madison might be as follows:

LIST OF ACCOUNTS RECEIVABLE, December 31, 192..

L. S. Lyon	$ 47.81
A. C. Hodge	56.26
N. W. Barnes	98.95
E. R. Lambert	96.91
J. H. Bishop	156.16
Total	$456.09

Merchandise on Hand

The merchandise on hand at the time the Balance Sheet is made is known as the Merchandise Inventory. It is listed under this heading among the assets on the Balance Sheet. The inventory of merchandise is obtained usually by making a physical count of the goods in stock and determining their value at cost price. There are cases in which the cost price is not used; these will be discussed later.

Debts Owed to Merchandise Creditors

It has been explained that those who purchase merchandise from the business may give either written or oral promises in payment. In the same manner the business may give either written or oral promises in payment of the merchandise purchased from others. The written promises so given are known as Notes Payable and the oral promises as Accounts Payable. In the illustration given, James Madison owes creditors $765.85. If it is assumed that $60.85 of this amount is represented by written promises and $705.00 is repre-

sented by oral promises, his debts to creditors may be shown on the Balance Sheet as follows:

Notes Payable	$ 60.85
Accounts Payable	705.00

The accounts payable, like the accounts receivable, are shown on the Balance Sheet as a total. Although the accounting records show the amount due to each creditor, it is not desirable to show the names of the individual creditors on the Balance Sheet. Sometimes a list of the creditors and the amount due each is attached to the Balance Sheet. Such a list of the creditors of James Madison might be as follows:

LIST OF ACCOUNTS PAYABLE, December 31, 192. .

M. L. Rose	$240.00
G. B. Brown & Co.	465.00
Total	$705.00

Balance Sheet with Accounting Terminology

After the foregoing discussion, it is possible to restate the assets and liabilities of James Madison, using the correct accounting terminology in enumerating them. Such a statement would be as follows:

ASSETS:		
Cash	$ 252.00	
Notes Receivable	27.92	
Accounts Receivable	456.09	
Merchandise Inventory	1,450.00	
Furniture and Fixtures	220.00	
Delivery Equipment	400.00	
Total Assets		$2,806.01
LIABILITIES:		
Notes Payable	$ 60.85	
Accounts Payable	705.00	
Total Liabilities		765.85
Net Worth or Proprietorship		$2,040.16

Heading or Title of the Balance Sheet

A Balance Sheet is made to show the financial condition of some specific firm and to show that condition at some specific date.

It is customary, therefore, to place the name of the firm and the date of the Balance Sheet as a heading, somewhat as follows:

JAMES MADISON

BALANCE SHEET, December 31, 192..

Subtitles of the Balance Sheet

The assets of all mercantile firms can be divided into at least two classes:

1. Those in the form of cash and those which it is expected will be converted into cash in the near future in the regular operations of the business. In accounting, these are termed Current Assets.

2. Those which are used in the regular operation of the business but which it is not expected will be sold or turned into cash. In accounting, these are called Fixed or Permanent Assets.

By referring to the Balance Sheet of James Madison it will be seen that he has cash to the amount of $252.00; debts due from customers, which he expects to collect in the near future, $484.01 (oral promises, $456.09; written promises, $27.92); and merchandise on hand, $1,450.00, which he plans to sell and realize in cash within not an unreasonable length of time. Consequently he has current assets to the amount of $2,186.01. In addition he has furniture and fixtures valued at $220.00 and delivery equipment valued at $400.00. These assets he expects to retain in his business and does not expect to liquidate in cash. His fixed assets, therefore, amount to $620.00.

In a similar manner the liabilities of a firm may be divided into two classes:

1. Those which the business promised to pay within a short time after they were incurred, such as debts due to merchandise creditors and to banks. These are called Current Liabilities.

2. Those which are of long time duration and may not have to be paid until several years after they are incurred. These are known as Fixed or Permanent Liabilities, for it is expected they will not be paid in the near future. Such liabilities will be discussed and illustrated in later chapters.

It will be seen by the Balance Sheet of James Madison that his only liabilities are those to creditors, which amount to $765.85 (oral promises, $705.00; written promises, $60.85). According to good

business practice these will be paid in the near future, hence these are current liabilities. Madison has no long time obligations; hence no fixed liabilities are shown on his Balance Sheet.

In addition to the assets and liabilities, the proprietorship or net worth of the business is shown on the Balance Sheet. This is shown under the separate heading or title of "Proprietorship," "Net Worth," "Capital," or some similar term.

Since the purpose of the Balance Sheet is to give as much information as possible about the assets and liabilities of a business it is desirable to classify the assets and liabilities according to their nature. The method of showing these classifications is illustrated in the Balance Sheet given in Illustration No. 1. Frequently, subdivisions of assets and liabilities other than those discussed above are shown on the Balance Sheet, but those given are sufficient for the present discussion.

James Madison
Balance Sheet, December 31, 192

Assets				
Current Assets.				
Cash	252			
Notes Recievable	27	92		
Accounts Recievable	456	09		
Merchandise Inventory	1450			
Total Current Assets			2186	01
Fixed Assets				
Furniture and Fixtures	220			
Delivery Equipment	400			
Total Fixed Assets			620	
Total Assets			2806	01
Liabilities				
Current Liabilities:				
Notes Payable	60	85		
Accounts Payable	705			
Total Current Liabilities			765	85
Net Worth or Proprietorship			2040	16

Illustration No. 1—Balance Sheet—"Report" Form

Illustration of the Standard Form of Balance Sheet*

Using the items and amounts previously given, a Balance Sheet, which will comply with the accounting principles discussed, may be made for James Madison in the form illustrated on page 38.

A Balance Sheet such as the one given on the preceding page is said to be in the "report" form. While this arrangement correctly shows the financial condition of a business, accountants more frequently use the form given in Illustration No. 2, which is known as the "account" form:

James Madison
Balance Sheet, December 31, 192

Assets					Liabilities & Proprietorship				
Current Assets					Current Liabilities:				
Cash	252				Notes Payable	60	85		
Notes Receivable	27	92			Accounts Payable	705			
Accounts Receivable	456	09			Total Current Lia.			765	85
Mdse. Inventory	1450				Net Worth or Proprietorship			2040	16
Total Current Assets			2186	01					
Fixed Assets:									
Furniture & Fixtures	220								
Delivery Equipment	400								
Total Fixed Assets			620						
Total Assets			2806	01	Total Liabilities & Prop.			2806	01

Illustration No. 2—Balance Sheet—"Account" Form

The student will notice that both of these Balance Sheets show the same facts. It is only the arrangement that is different. The first form is shown first in this chapter, because it is quite convenient for purposes of illustration. Both are according to good accounting practice, but the latter form is, at present, used more frequently by accountants in their reports. In the printed forms given by banks to customers on which to report their financial condition, the first form is quite frequently called for by the arrangement of the items on the printed blanks. So far as the owner of a business is concerned either form serves his purpose.

* The depreciation of fixed assets is not discussed or illustrated in this chapter. Its omission is deemed advisable until the student has become familiar with the construction of the operating expense accounts and the method of adjusting and closing the ledger at the end of the fiscal period. He will then be able to see the effect of depreciation on the expenses of the business as well as on the assets. A discussion and an illustration of the treatment of depreciation are given in Chapter XVI.

QUESTIONS FOR CLASS DISCUSSION

1

You are working for the Merchants National Bank. Mr. G. W. Brown, a retail dry goods merchant, requests the bank to lend him $1,000.00. The president of the bank instructs you to investigate the financial condition of Mr. Brown and report to him whether you think the loan should be granted. What information would you request of Mr. Brown?

2

In response to your request, Mr. Brown gives you a statement of his assets and liabilities made as follows:

Assets	$10,000.00
Liabilities	3,000.00
Proprietorship	$ 7,000.00

Would this statement be satisfactory to you? Why?

3

Assuming your own figures and items, but using the above totals, explain how you would wish Mr. Brown to make his statement of assets and liabilities.

4

How would Mr. Brown obtain the information necessary to make the above-mentioned statement?

5

On the Balance Sheet of Mr. Brown the following items appear:

Notes Receivable	$1,500.00
Accounts Receivable	500.00

What might you infer from the fact that notes receivable are three times as large as accounts receivable? Would you regard this favorably or unfavorably?

6

The Balance Sheet of Mr. Brown which he submits to the Merchants National Bank is dated December 31, 1919. Mr. Brown desires a Balance Sheet of the same date which will enable him to judge the success of his business. Will this latter Balance Sheet be different from the one he submits to the bank for the purpose of obtaining credit?

7

Mr. Brown has 150 customers who owe him on account. How will the amount which they owe be shown on his Balance Sheet? If it is desirable for the bank to know the names of the individuals who owe Mr. Brown, how may this information be provided?

8

On the Balance Sheet of Mr. Brown, merchandise inventory is stated at $1,450.00. How did Mr. Brown obtain the value of this inventory?

9

Define and illustrate the difference between current assets and fixed assets; current liabilities and fixed liabilities.

10

In what forms may the Balance Sheet be made? What is the distinguishing difference between the two? Is the difference one of form or of content?

LABORATORY MATERIAL

The purpose of the following exercises is to give practice in preparing Balance Sheets as explained and illustrated in Chapter III. These exercises are to be prepared on loose sheets of paper ruled similar to Illustration No. 1 or No. 2, depending on the form of Balance Sheet required in the exercise.

Exercise No. 11

On December 31, 1918, C. A. Reynolds has the following property:

Cash	$240.00	
Notes Due from Customers	200.00	
Accounts Due from Customers:		
A. R. James	54.00	
Central Hotel	129.00	
A. C. Williams	42.00	
R. G. Roberts	24.00	
C. L. Hall	28.00	
J. C. Jones	45.00	
Merchandise Inventory	880.00	
Furniture and Fixtures	90.00	
He owes Creditors:		
King & Company		$ 96.00
Hazen & Logan		103.00
Matthews & Company		200.00
Wisdom Brothers		175.00
City Creamery		29.00
He owes the Second National Bank for Money Borrowed		300.00

Instructions: Make a Balance Sheet in report form for Reynolds as of December 31, 1918, showing assets and liabilities properly classified.

List the accounts receivable and payable as totals.

Exercise No. 12

An investigation of Reynolds' records one year later shows the following:

1. Cash on hand is $100.00 larger.
2. Notes receivable from customers have decreased $50.00.
3. Accounts receivable have increased $400.00.
4. Accounts payable are $500.00 larger.

5. The notes due to bank amount to $500.00.
6. Furniture and fixtures have decreased in value $9.00.
7. Delivery equipment, $300.00.
8. Inventory of merchandise $1,250.00.

Instructions: Make a Balance Sheet in report form for Reynolds as of December 31, 1919. Show assets and liabilities properly classified.

Exercise No. 13

Show in *account* form the Balance Sheet required in Exercise No. 12.

Exercise No. 14

P. C. Dodge, who is engaged in the hardware business, has the following assets and liabilities on June 30, 1920:

Cash	$ 300.00
Accounts Due from Customers	1,800.00
Notes Due from Customers	75.00
Hardware on Hand	2,200.00
Furniture and Fixtures	250.00
Due to First National Bank	500.00
Accounts Due to Creditors	800.00
Notes Due to Merchandise Creditors	50.00

Instructions: Make in report form a Balance Sheet for P. C. Dodge as of June 30, 1920. Amounts due the bank and notes due merchandise creditors may be listed in one amount under Notes Payable.

Exercise No. 15

A. M. Jones, is engaged in operating a garage and in selling automobile accessories. On July 31, 1920, he has the following assets and liabilities:

Automobile Supplies	$1,250.00
Tools and Equipment in Garage	420.80
Showcases and Counters	60.20
Accounts Due from Customers	125.87
Accounts Due to Creditors	220.00
Due to the Merchants Trust Company	80.00
Cash	210.00
Automobile Used for Service	800.00

Instructions: Make in account form a Balance Sheet for A. M. Jones as of July 31, 1920. List the last item as Delivery Equipment.

Exercise No. 16

J. M. Clark is the proprietor of a drug store. On March 31, 1920, his assets and liabilities are as follows:

Drugs and Miscellaneous Merchandise on Hand	$2,800.00
Showcases and Cabinets	300.00
Soda Fountain	500.00
Bicycle Used by Delivery Boy	15.00
Electric Advertising Sign in Front of Store.	20.00
Cash	350.00
Due to Local Bank	450.00
Due to Creditors	500.00

Instructions: Make a Balance Sheet in account form, for J. M. Clark as of March 31, 1920.

Exercise No. 17

M. M. McGee is the proprietor of a millinery store with the following assets and liabilities on January 31, 1920:

Hats on Hand	$800.00
Showcases and Counters	150.00
Supplies to be Used in Trimming and Remodeling	220.80
Equipment in Working Room	120.50
Due from Customers	40.50
Due to Creditors	250.00
Cash	150.00

Instructions: Make in report form a Balance Sheet for M. M. McGee as of January 31, 1920.

Exercise No. 18

R. C. Riley is proprietor of a barber shop. On September 30, 1919, he has the following assets and liabilities:

Hair Tonics, Face Creams and Miscellaneous Supplies	$125.00
Chairs and Equipment	450.00
Showcase for Cigars	40.00
Cigars on Hand	120.00
Cash	150.00
Due to Local Bank	50.00

Instructions: Make in report form a Balance Sheet for R. C. Riley as of September 30, 1920.

Exercise No. 19

C. A. Anderson, who is engaged in the retail implement business, has on December 31, 1919, the following assets and liabilities as shown by his accounting records:

Cash	$ 300.00	
Notes Receivable	220.00	
Account Due from Customers:		
O. T. Gooch	190.00	
John K. Dew	55.00	
W. E. Hampton	50.00	
R. E. Taylor	75.00	
D. D. Dwyer	120.00	
H. L. Cohagen	250.00	
Merchandise Inventory	2,000.00	
Furniture and Fixtures	75.00	
Delivery Equipment	125.00	
Due to the Continental Trust Co.		$300.00
Due to Creditors as Follows:		
H. M. Gooch		120.00
A. M. Joesting		150.00
James M. Monroe		180.00

Instructions: Make in account form a Balance Sheet for C. A. Anderson as of December 31, 1919.

Exercise No. 20

From your own data draw up a Balance Sheet in account form for James King, retail dry goods merchant. Have at least six assets and two liabilities. Arrange in the same form as Illustration No. 2.

CHAPTER IV

THE STATEMENT OF PROFIT AND LOSS

Purpose of the Statement of Profit and Loss

It has been explained in a previous chapter that the owner of property, such as cash, furniture, merchandise, etc., uses it in conducting a business because he expects by using it to make a profit a part of which, at least, he can withdraw as income. When the owner of property invests it he expects the accounting records of the business to provide him information which will show him: first, whether a profit is being made and, if so, the amount thereof, and second, how he can plan to use his property in the future to increase his profits. In order to give this information to the owner so it can be easily understood and applied, certain reports or statements are used. These reports show in a summarized and classified form the information which the accounting records contain.

In the preceding chapter the Balance Sheet has been discussed and illustrated as a means by which to give the owner information about his assets, liabilities, and proprietorship. It was explained that the owner, by a comparison of the amount of his proprietorship at two different times, as shown by the two Balance Sheets, can determine whether it has increased or decreased. It should be realized, however, that the Balance Sheet does not show the cause of this increase or decrease. An illustration or two will make this apparent.

The Balance Sheet of James Madison, on December 31st, as given in Chapter III, shows his net worth or proprietorship to be \$2,040.16. If one month before, on November 30th, his Balance Sheet showed his net worth to be \$1,890.00, his proprietorship will have increased \$150.16 during the month. Consequently, if he has not withdrawn anything during the month or made an additional investment, he would assume that he had made a profit of \$150.16. Although this comparison of Balance Sheets may show Madison the profit which he has made, it does not show the reason or cause for the profit. A month later, when Madison makes his Balance Sheet on January 31st, he may find that his proprietorship has increased

only $50.00; hence his profits are $100.16 less than they were the month before. His Balance Sheet, however, will not show why his profits are smaller than for the previous month.

It may be that his sales for the month have been smaller or that the cost of the goods purchased has been more, or it may be that he has paid more for clerk hire, heat, light, and other expenses. He, of course, wishes to plan his business for the next month so as to remedy, if possible, the difficulty of the past month and not only avoid a decrease in his profits, but have an increase.

In order to obtain the information which he can use as a basis for such plans, he needs a report showing him his sales for the month, the cost of the goods sold, the expenses incurred in conducting his business, and the net profit resulting from his business operations. Such a report is usually made for the owner at the same time the Balance Sheet is prepared. This report is given various names, but in this text will, in accordance with quite prevalent practice, be termed the Statement of Profit and Loss.

Form of the Statement of Profit and Loss

Since the purpose of the Statement of Profit and Loss is to give the owner certain information which he can use in the management of his business, it should be in that form which gives this information most readily. As stated above, the Statement of Profit and Loss shows four principal items: sales for the period, cost of goods sold, expense of conducting the business, and net profit. The simplest form of a Statement of Profit and Loss, therefore, is one which shows these items as totals only.

If James Madison has made $1,561.74 sales during the month, the cost of the goods sold is $1,125.85 and the expenses incurred conducting the business are $285.73, with a resulting net profit of $150.16, his Statement of Profit and Loss might be made in the following form:

Sales for the Month	$1,561.74
Cost of Goods Sold	1,125.85
	$ 435.89
Expenses	285.73
Net Profit	$ 150.16

Such a statement would be of some value to Madison in itself and would be even of more value if compared with previous statements.

By such a comparison he could see not only the increase or decrease in net profit, but also whether his sales had increased or decreased and whether the cost of goods sold and the expenses of conducting his business had increased faster than his sales.

In the above illustration, Madison's sales are $1,561.74 and his expenses are $285.73, or a little more than 18% of his sales. It may be that his Statement of Profit and Loss for the previous month shows sales of $1,200.00 and expenses of $180.00, or 15% of sales. If his profit has not increased as he thinks it should in view of the increase in sales he will have at least a partial explanation in the fact that the expenses have increased so much faster than the sales. A comparison of the cost of goods sold with the sales might show a similar result and possibly explain why his profit is not more or probably even less, though his sales have materially increased. It can be readily seen how such a statement gives very important information which the Balance Sheet does not show.

Cost of Merchandise Sold

Although such a statement as that given above would give the owner valuable information, there is some additional information which he usually desires and which the Statement of Profit and Loss should give him. In the first place, the cost of merchandise sold is obtained by a combination of, at least, three items and it is customary to show these separately on the Statement of Profit and Loss.

If Madison had merchandise valued at $1,000.00 on hand at the beginning of December and purchases $1,575.85 worth of merchandise during the month, he should have $2,575.85 worth of merchandise on hand on December 31st, if none has been sold. He has been selling, however, throughout the month and on December 31st, by actual count, he finds he has but $1,450.00 worth of merchandise on hand. He assumes that the merchandise not on hand must have been sold. Consequently, by subtracting $1,450.00, the value of the merchandise on hand on December 31st, from $2,575.85, the value of the merchandise on hand on December 1st plus the purchases made during the month, he obtains a difference of $1,125.85, which represents the cost of the merchandise sold during the month.

As previously stated, the goods in which a firm deals are known as merchandise and the amount on hand at any particular time is known as the merchandise inventory. In view of the above, it may

be understood easily why the cost of merchandise sold is shown on the Statement of Profit and Loss as follows:

COST OF MERCHANDISE SOLD:		
Mdse. Inv., Dec. 1, 192.	$1,000.00	
Purchases	1,575.85	
	$2,575.85	
Less Mdse. Inv., Dec. 31, 192. . .	1,450.00	
Net Cost of Merchandise Sold		$1,125.85

Gross Profit on Sales

When the cost of merchandise sold is subtracted from sales the difference represents the profit which would be made if no expenses were incurred in conducting the business. Expenses are always incurred, however, in the sale of goods, therefore it is necessary to consider them in determining the profit. Consequently the difference between the amount received from sales and the cost of merchandise sold is termed Gross Profit on Sales. It is termed *gross* profit because the expenses must be deducted in order to obtain the final or *net* profit.

James Madison has made sales to the amount of $1,561.74 and the cost of the merchandise sold is $1,125.85; hence the gross profit on sales is $435.89. It appears on the Statement of Profit and Loss as in Illustration No. 3.

Classification of Expenses

In the illustration on page 47, the expenses of James Madison are shown in one item, $285.73. Although all the expenses of the business may be shown as one total, it is desirable, in order that a proper analysis of the operations of the business may be made, that expenses be divided into at least two classes. The first class includes those expenses incurred directly in the sale of merchandise, such as wages of sales clerks, advertising, delivery expenses, etc. These are known as Selling Expenses. The second class includes those expenses incurred in the general conduct of the business, such as stationery, postage, office supplies, salaries and wages of office help, telephone, fuel, light, etc. These are known as Administrative Expenses. If it is assumed that $140.00 of the expenses of Madison are of the first class and $145.73 are of the second class, they will be shown on the Statement of Profit and Loss as follows:

Selling Expenses	$140.00
Administrative Expenses	145.73

Operating and Non-Operating Expenses

In the conduct of a business the owner incurs certain expenses which are the result of the regular operations of the business. These are known as Operating Expenses. All those mentioned above under the headings of selling and administrative expenses are of this type. In addition, the owner may incur certain other expenses which are not directly connected with the regular operations of the business; these are called Non-Operating Expenses. For instance, James Madison may have an opportunity to purchase a delivery truck from another merchant, who is going out of business, at what he judges to be a very advantageous price. Although he does not need the truck in connection with his delivery service, he purchases it and keeps it some time before he is able to sell it for a profit. Certain expenses are incurred in the meantime for garage space for the truck. These expenses have no relation to the cost of conducting his store, so should not be included in the selling expenses of the store as are the expenses incurred in connection with trucks which he uses in his delivery service.

For the present, such non-operating expenses can be disregarded, for they would not be of frequent occurrence in the case of a small store like that owned by James Madison. Later they will be discussed and the method of showing them on the Statement of Profit and Loss will be illustrated. The purpose of mentioning them here is to point out to the student that such expenses are not included in the operating expenses of the business; likewise to explain that the operating expenses of the business are usually indicated as such on the Statement of Profit and Loss as follows:

OPERATING EXPENSES:		
Selling Expenses	$140.00	
Administrative Expenses	145.73	$285.73

Heading or Title of the Statement of Profit and Loss

The Statement of Profit and Loss is made to show the result of the operations of some specific business and to show the result of those operations for some specific period. As previously stated, the Balance Sheet is made to show the financial condition on a particular date, such as December 31st, but the Statement of Profit and Loss is made to show the results of the operations for a period of time, such as from December 1st to December 31st. This period of time, which is covered by the Statement of Profit and Loss, and at the end of which the Balance Sheet and other statements may be

made, is known as a *fiscal* period. The fiscal period of a business is often a year, but it may be a shorter period of time, such as a month, quarter year, or half year. In the foregoing discussion it has been assumed for the sake of brevity and simplicity that the fiscal period of James Madison is one month. The *principles* governing the construction of the Balance Sheet and Statement of Profit and Loss are the same for a long fiscal period as for a short one.

The name of the firm and the period of time for which the Statement of Profit and Loss is made are indicated as follows:

JAMES MADISON

STATEMENT OF PROFIT AND LOSS FOR THE MONTH ENDING DECEMBER 31, 192..

Standard Form of the Statement of Profit and Loss

Using the items and amounts previously given, a Statement of Profit and Loss, complying with the accounting principles discussed, may be made for James Madison in the following form:

James Madison

Statement of Profit and Loss for Month Ending Dec. 31, 192

Sales			1561	74
Cost of Merchandise Sold:				
Merchandise Inventory Dec. 1, 192 1000.00				
Purchases 1575.85	2575	85		
Less Merchandise Inventory Dec. 31, 192	1450			
Cost of Merchandise Sold			1125	85
Gross Profit on Sales			435	89
Operating Expenses				
Selling Expenses	140			
Administrative Expenses	145	73	285	73
Net Profit			150	16

Illustration No. 3—Statement of Profit and Loss

A Statement of Profit and Loss with the arrangement just given is said to be in the *report* form. It is possible to make this statement in what is known as the *account* form, but this form is so rarely used that it is not deemed desirable to discuss it at this point. The

above form is the one universally used by accountants and its arrangement should be thoroughly mastered by the student.

Use of Reports by the Owner or Manager of a Business

In the preceding discussion it has been particularly emphasized that the primary function of accounting is to give the owner the information which he needs in order to operate his business successfully, and that reports should be made which will give this information in a condensed though comprehensive and usable form. The Balance Sheet and the Statement of Profit and Loss have been discussed and illustrated because they are the reports which are most universally made, and because they give the owner the information which he usually regards the most important.

In a large business many reports other than the Balance Sheet and the Statement of Profit and Loss are required in order to present the various information which the owner needs in the management of his business. If, however, the student understands the use of the Balance Sheet and the Statement of Profit and Loss and how the accounting record is used to obtain this information as illustrated in a simple business like that of James Madison, he should have no difficulty in understanding more complicated reports with the attendant accounting records when they are explained later.

QUESTIONS FOR CLASS DISCUSSION

1

You have $5,000.00 to invest and you decide to purchase a retail dry goods store. You have an opportunity to buy either of two stores for this sum. The assets and liabilities of each store which are exactly the same, are as follows:

Assets	$10,000.00
Liabilities	5,000.00
Proprietorship	$ 5,000.00

What information about these two stores would you desire before you decide which to purchase?

2

Mr. Jones has two stores. The Balance Sheet of No. 1 is as follows:

STORE NO. 1

Balance Sheet, December 31, 1918

Assets	$12,000.00
Liabilities	4,000.00
Proprietorship	$ 8,000.00

The Balance Sheet of No. 2 is as follows:

STORE NO. 2

Balance Sheet, December 31, 1918

Assets	$6,000.00
Liabilities	2,000.00
Proprietorship	$4,000.00

During the past year Store No. 1 has made a profit of $800.00 and Store No. 2 has made a profit of $600.00. Which store is the better investment for Mr. Brown?

3

James Arnold purchases $4,000.00 worth of merchandise during the month of January and sells $3,000.00. At the end of the month he has $1,500.00 worth of merchandise on hand. Assuming that he

had no merchandise on hand at the beginning of the month and ignoring any expenses incurred, has he lost or gained as a result of his month's trading?

4

Since expenses are not considered in finding the profit of Arnold for the month what should the profit determined above be termed?

5

A. R. Manley had merchandise on hand on January 1st valued at $2,000.00. During the month he purchased $6,000.00 worth of merchandise and sold $8,000.00. On January 31st his inventory amounted to $2,200.00. His expenses for the month had been $900.00. What was his net profit for the month?

6

At the end of the next month the Statement of Profit and Loss of Manley shows that he has made a profit of only $500.00. He is puzzled as to the cause of the decrease and asks your advice. In looking over his records you find that $500.00 lost in trading on the Stock Exchange has been added to his expenses for the month. What report would you make to him?

7

On December 31, 1918, the Statement of Profit and Loss of N. W. Barnes in summary form is as follows:

Sales for the Year	$18,000.00
Cost of Goods Sold	10,000.00
Gross Profit on Sales	$ 8,000.00
Operating Expenses	6,000.00
Net Operating Profit	$ 2,000.00

One year later the Statement of Profit and Loss of Barnes is as follows:

Sales for the Year	$36,000.00
Cost of Goods Sold	21,000.00
Gross Profit on Sales	$15,000.00
Operating Expenses	13,500.00
Net Operating Profit	$ 1,500.00

Mr. Barnes is surprised to find that though his sales have doubled his profits have decreased. He asks you for an explanation. What explanation would you give him?

Explain and illustrate the distinction between operating and non-operating expenses.

9

Explain and illustrate how the operating expenses of a business may be classified.

10

What is a *fiscal* period? What is the usual length of the fiscal period? What relation has the fiscal period to the heading and title of the Statement of Profit and Loss?

LABORATORY MATERIAL

The purpose of the following exercises is to give practice in preparing Statements of Profit and Loss as explained and illustrated in Chapter IV. These exercises are to be prepared on loose sheets of paper ruled similar to Illustration No. 3:

Exercise No. 21

On January 1, 1920, the inventory of merchandise of Mr. E. R. Taylor, retail grocer, was $1,200.00. During the month he purchased $1,950.00 worth of merchandise and sold $2,280.00. On January 31st he has an inventory of $1,400.00. During the month his expenses have been as follows:

Salary of Clerk Employed in Selling	$70.00
Heat, Light and Water	16.00
Stationery and Postage	3.00
Advertising in Local Paper	10.00
Rent of Store	50.00
Incidentals	5.00

Instructions: Make a Statement of Profit and Loss for Mr. Taylor for the month of January. Incidentals are classified as administrative expenses.

Exercise No. 22

On March 1, 1920, the inventory of merchandise of O. H. Robinson, a retail hardware merchant, is $2,800.00. During the month he purchases merchandise, $2,500.00, and sells $3,580.60. On March 31st he has an inventory of $2,900.00. During the month his expenses have been as follows:

Salaries of Clerks Employed in Selling . . .	$130.00
Heat, Light and Water	18.00
Advertising in Local Paper	10.00
Stationery and Postage	4.00
Rent of Store	60.00
Repairs to Store Furniture and Fixtures . .	8.00
Paper and Twine for Wrapping Merchandise Sold	27.80
Cost of Drayage for Delivering Hardware to Customers	19.56

Instructions: Make a Statement of Profit and Loss for Mr. Robinson for the month of March.

Exercise No. 23

Mr. A. H. Johnson, public accountant, receives as fees for services during the year 1919, $9,156.75. His expenses for the year are as follows:

Rent of Offices	$ 700.00
Salaries of Office Help	2,250.00
Light and Telephone Service for Office	40.00
Stationery and Office Supplies	56.78
Cost of Clerical Assistance in Connection with Work Done	1,200.00

Instructions: Make a statement showing the net income of Mr. Johnson for the year 1919.

Exercise No. 24

On June 1, 1919, the inventory of merchandise of J. H. Anthony, retail druggist, is $3,200.00. During the month he purchases merchandise, $2,385.68 and sells $2,756.90. His inventory on June 30th is $2,845.73. His expenses for the month are as follows:

Salaries of Sales Clerks	$215.00
Rent of Store Building	50.00
Light	5.00
Telephone	3.00
Salary of Janitor	40.00
Advertising in Local Paper	12.00
Twine and Wrapping Paper	8.00
Repairs to Store Fixtures	2.50
Incidental Expenses	3.46

Instructions: Make a Statement of Profit and Loss for Mr. Anthony for the month of June.

Exercise No. 25

The inventory of James King, retail grocer, of January 1, 1918, is $2,500.00. His purchases for the year are $18,000.00, and his

sales $24,000.00. His merchandise inventory on December 31, 1918, is $4,500.00. His expenses for the year are as follows:

Salaries of Sales Clerks	$1,500.00
Cost of Delivering Merchandise to Customers	400.00
Cost of Advertising	80.00
Cost of Miscellaneous Supplies Used in Connection with Goods Sold	20.00
Rent of Store	1,600.00
Salary of Mr. King Which Is Treated as an Administrative Expense	1,800.00
Insurance and Taxes	200.00
Miscellaneous Expenses of a General Nature, Including Heat, Light, Telephone, etc. .	400.00

Instructions: Make a Statement of Profit and Loss for Mr. King for the year of 1918.

Exercise No. 26

During the year of 1919 the sales of Mr. King amount to $48,000.00. His purchases amount to $42,000.00, and his inventory at the end of the year is $15,200.00. His selling expenses for the year amount to $6,000.00, and his administrative expenses to $9,000.00.

Instructions: 1. Make a Statement of Profit and Loss for Mr. King for the year of 1919.

2. State in outline form three reasons why Mr. King's profit for the year has not increased although his sales have doubled.

Exercise No. 27

On January 1, 1919, The Commercial Text Book Company has books on hand to the value of $18,250.00. During the year 1919 the cost of books printed is $92,000.00, and the sales for the year amount to $126,000.00. On December 31st, the inventory of books on hand is $22,650.00. The expenses for the year are as follows:

Salesmen's Salaries	$8,250.00
Salesmen's Expenses	6,214.86
Advertising Expenses	2,359.45
Stationery and Postage	349.50
Salaries of Office Help	2,850.00
Miscellaneous Office Expenses	3,856.00

Instructions: Make a Statement of Profit and Loss for The Commercial Text Book Company for the year 1919.

Exercise No. 28

The inventory of merchandise of the X Y Company on October 1st was $4,000.00. During the month of October it purchases $12,000.00 of merchandise and sells $15,000.00. On October 31st its inventory is $3,000.00. During the month the following payments have been made:

Clerk Hire (administrative purposes)	$200.00
Heat and Light	25.00
Advertising	150.00
Salesmen's Expenses	75.00
Salesmen's Salaries	120.00
Stationery	10.00
Incidentals	25.00

Instructions: Make a Statement of Profit and Loss showing the net profit of the company for the month of October.

Exercise No. 29

During the month of November the X Y Company purchases $15,000.00 merchandise and sells $16,000.00. The company's inventory on November 30th is $6,500.00. During the month the following payments were made:

Clerk Hire (administrative)	$250.00
Heat and Light	45.00
Advertising	180.00
Salesmen's Expenses	100.00
Stationery	12.00
Incidentals	35.00
Salesmen's Salaries	130.00

Instructions: Make a Statement of Profit and Loss for the X Y Company for the month of November.

Exercise No. 30

The inventory of merchandise of J. H. Bishop on January 1, 1919, is $2,500.00. His sales during the year are $24,000.00, and

his purchases are $18,000.00. His inventory on December 31st is $3,500.00. During the year his expenses are as follows:

Salaries of Sales Clerks	$1,200.00
Delivery Expenses	700.00
Advertising	100.00
Rent of Store	1,400.00
Insurance and Taxes	400.00
Salary of Manager	1,800.00
General Expenses	400.00

Instructions: Make a Statement of Profit and Loss showing the result of the operations for the year.

CHAPTER V

THE ACCOUNT

Purpose of the Account

The owner or manager of a business, as previously stated, desires from time to time certain reports that will give him the information which will assist him to manage and control the operations of his business. The Balance Sheet and the Statement of Profit and Loss, the two reports of primary value in business management since they are in the main the basis of all other reports, have been discussed in the two preceding chapters. These reports are always made at the end of the fiscal year, and they may be made at more frequent intervals. The present tendency is to make the fiscal period shorter than it was formerly. Consequently, many businesses have a Balance Sheet and a Statement of Profit and Loss prepared at the end of each month. It is evident that to make such statements at the end of the year or fiscal period some means must be devised to obtain the information which they contain.

For instance, in order that James Madison may be able to make a Balance Sheet he must know the amount of the various items which appear thereon. In the case of some items, such as cash and notes receivable, he could obtain the amount by actual count. However, he would have no means of knowing whether the cash actually on hand was correct unless he knew the total cash received during the period and the total cash paid so he could check the difference, or balance on hand, against the amount obtained by physical count. In the same manner he must know the total of the notes received from customers during the period and the total of these notes which have been paid so he can check the difference against the notes actually on hand. In the case of some items, such as accounts receivable, the amount can not be obtained by count because they are not represented by anything tangible. For this reason the only possible means of knowing the amount due from customers is to have a record of the oral promises received from customers and the promises which they have paid or redeemed in order to obtain the difference which represents the accounts receivable unpaid. It is likewise

impossible to know the amount of the notes payable or accounts payable owed by the business unless a record is kept of the written and oral promises given, and the written and oral promises redeemed.

If the Statement of Profit and Loss is considered, a similar, if not even a more apparent, necessity for some means of collecting such information is seen. It would be impossible for James Madison to remember that his sales have been $1,561.74 during the month, that his purchases have been $1,575.85, that his selling expenses $140.00, and his administrative expenses $145.73. In order that he may be able to obtain a Statement of Profit and Loss at the end of the month, there must be a record made of these items so that the amount of each may be ascertained.

To have available in convenient form at the end of the fiscal period the information which is needed to make the reports discussed above, there is employed what is known in accounting as the Account. An account may be defined as a systematic record of information pertaining to some item which appears in the accounting reports, kept under an appropriate heading or title. The necessity and purpose of accounts are sufficiently indicated by the above discussion. The nature and arrangement of the information which accounts in general contain, will be discussed in the remainder of the present chapter. The construction and interpretation of particular accounts will be discussed in the chapters immediately following.

Construction of the Account

As suggested above, an account is kept with each item of information which is needed in making the accounting reports, such as the Balance Sheet and the Statement of Profit and Loss. Consequently, accounts are kept with assets, such as cash, notes receivable, accounts receivable, office furniture, and delivery equipment; with liabilities, such as notes payable and accounts payable; with expenses, such as cost of selling and administration; and with sources of income, such as sales. In later chapters it will be shown that when more detailed information is desired on the Balance Sheet and the Statement of Profit and Loss, it is necessary to have additional accounts so as to obtain this information. For the present it is not necessary to consider accounts other than those necessary to provide the information which appears on such simple statements as the Balance Sheet and the Statement of Profit and Loss of James Madison, as given in previous chapters.

As stated in the definition, the information which the account contains is kept under an appropriate heading or title. The title of the account should indicate clearly the content of the account, for otherwise when later this item appears on the reports it will be misleading. A title which does not clearly and accurately indicate the nature of the account may be misleading or ambiguous. It may also afford an opportunity for hiding in this account information which it is essential to have stated separately so that it may be called to the attention of those responsible for passing judgment on it.

In making the accounting record it is necessary to record facts of opposite tendencies in the same account. For instance, in the account with Cash it is necessary to record the cash received and also the cash paid so as to be able to offset the two and obtain the cash on hand. The same is true with reference to accounts receivable, for it is necessary to record both the oral promises received and the oral promises paid in order to determine the difference, or the accounts receivable unpaid. Since, sooner or later, it is necessary to record facts of opposite tendencies in all accounts, it is necessary to divide the account into two sections in order to make possible a division of these opposing facts. These two sections, which for the present may be called the right section and the left section, may be constructed as in Illustration No. 4.

Cash

(1)	(2)	(3)	(4)	(5)							
1920						1920					
Jan.	1	Balance		2,000	00	Jan.	31	Accts. Payable		3,000	00
	31	Accts. Receiv.		4,000	00		31	Selling Expenses		500	00
	31	Cash Sales		1,000	00		31	Admr. Expenses		800	00

Illustration No. 4—The Account

The use of the columns, as indicated in the left section of the above illustration, is as follows:

(a) Columns (1) and (2) are the date columns, the first being used for the month, and the second for the day of the month. After the month is once written it need not be repeated. The year may be indicated by being written just above the month.

(b) Column (3) is the explanation column where any information which is thought desirable may be written. In many cases this column is left blank.

(c) Column (4) is called the folio column. As will be explained later, it is customary to first place the information contained in the

account in other records and then tranfer it to the account in which case the page of the record from which it comes is placed in the folio column. Sometimes the initials or symbol of the record from which it comes, as well as the page, are placed here.

(d) Column (5) is the amount or money column, the wider space being for dollars and the narrower space for cents.

The use of the columns of the right section of the account is identical with the use of those of the left section as explained.

The Balance of the Account

An inspection of the illustration given will make apparent how the account is used to record facts of opposite tendencies. On the left section of the illustration a total of $7,000.00 cash receipts is shown. On the right section cash disbursements, which are directly opposite to cash receipts, are shown to the amount of $4,300.00. By subtracting the totals of the two sides of the account a difference of $2,700.00 is obtained, representing the cash on hand. This is the amount which would be placed on the Balance Sheet if one were made at this time.

From the illustration of the Cash account on page 63, it can be seen that addition is indicated by placing the item to be added immediately beneath the item or items to which it is to be added, and on the same side of the account. It is desired to add the $4,000.00, received from customers in payment of debts due from them, and the $1,000.00, received from cash sales, to the balance on hand at the beginning of the month so as to show the total cash in the possession of the business during the month. Consequently these two items of cash receipts are placed immediately beneath the beginning balance of $2,000.00. On the other hand, the same illustration shows that items to be subtracted are placed on the opposite side of the account from the item or items from which they are to be deducted. In the Cash account, it is desired to subtract the cash payments from the cash receipts; hence it will be seen that the amounts paid to creditors and the amounts for selling expenses and administrative expenses are placed on the opposite side from the cash receipts. If the student will remember this phase of the mechanism of the account it will assist him greatly in making entries affecting particular accounts. It is necessary to remember this in order to obtain the balance of the account explained in the next paragraph.

As previously stated, the account is divided into two sections so that items pertaining to the same account, but of opposite tendencies,

may be kept separate when recorded in it. If the items recorded on the two sides of the account are equal in amount the account is said to *balance;* i. e., the items of one side balance or cancel the items on the other. If, however, the items on the opposite sides of the account are not equal, the difference between the two sides is called the Balance of the Account. In Illustration No. 4, the cash on hand, or $2,700.00, is the balance of the Cash account.

Meaning of Account Balances

A title for the account should be chosen that will indicate clearly the meaning of the Account Balance so there will be no difficulty in deciding as to its treatment on the accounting reports. If the student is familiar with the name and nature of the items which appear on the Balance Sheet and the Statement of Profit and Loss, he should have no difficulty in interpreting the balances of the accounts which are kept with these items. For instance, cash appears on the Balance Sheet as a current asset; therefore the student will realize at once that the balance of the Cash account is a current asset. Accounts payable appears on the Balance Sheet as a current liability; hence the balance of the Accounts Payable account is a current liability. Selling expense appears on the Statement of Profit and Loss as an operating expense; therefore the balance of the Selling Expense account is an operating expense. Similarly, the same principle governs in reference to all other accounts—the meaning and the nature of the balance are dependent upon its treatment on the accounting reports.

In the definition of the account, it was stated that it is a *systematic* record of information, which implies that a uniform procedure is followed in the construction of the account. A part of this uniform procedure is: when an asset is received by the business or an expense incurred, its amount is placed on the left hand side of the account which indicates its nature. On the other hand, when a liability is incurred or an item of income earned, the amount of the liability is placed on the right side of the account which indicates its nature, and the amount of the income on the right side of the account which indicates its source. Since proprietorship is the difference between assets and liabilities, and assets are shown on the left side of the accounts and liabilities on the right side, it, quite logically, is placed on the right side of the account which is kept to indicate its nature.

Consequently, the balance of an account which is larger on the left side represents either an asset or an expense, while the balance

of an account which is larger on the right side represents a liability, an income, or a proprietorship. As previously stated, if the student is familiar with the items which appear on the accounting reports he will have no difficulty in interpreting the balances of the accounts kept with these items.

The Ledger and Its Content

The accounts of a business are arranged in a systematic order in a book called the Ledger. The ledger is usually a bound book, the pages of which are ruled as in Illustration No. 4. It is sometimes defined as the book of accounts. In it is collected, in summarized form under appropriate account titles, the information necessary to make the accounting reports. There should be an account kept for each item of information which the owners desire on the reports from which they obtain the information used in the management of the business.

The number of accounts kept, therefore, will depend on the nature and amount of the information desired. Unnecessary accounts should not be kept, but the function of accounting is to provide as much useful information as possible and, since it is usually easier to combine statistical information than it is to analyze it, it is better to have accounts which will later be combined than to have accounts which must be analyzed. In the chapters immediately following, only a few accounts, such as a simple business like that of James Madison would require, will be discussed. In future chapters other accounts that would be required by a larger and more complicated business will be explained and illustrated.

Relation of Debit and Credit to the Account

In the foregoing discussion it has been explained that the account is divided into two sections so that facts which relate to the same account but which are of opposite tendencies may be recorded therein. In accounting practice the left section of the account is known as the *debit* side and the right section is known as the *credit* side.

It follows logically, then, that the items entered on the left side of the account are known as *debits* and the items entered on the right side of the account are known as *credits*. In the Cash account given in Illustration No. 4, the $4,000.00 received on account from customers and the $1,000.00 received from cash sales are debits. In the same account the $3,000.00 paid to creditors, the $500.00 paid

for selling expenses, and the $800.00 paid for administrative expenses are credits.

When an item is entered on the debit side the account is said to be debited, and when an item is entered on the credit side it is said to be credited. If the debits to an account exceed the credits to the account it is said to have a debit balance, while if the opposite is true, it has a credit balance.

There has been much discussion of the origin of the terms debit and credit and the development of their present use. Although this has some historical interest, such a discussion would be more confusing than beneficial to the student at this time. If he understands their present use with reference to accounts, as above explained, it will be sufficient for all practical purposes.

Relation of the Business Transaction to the Account

The operations of a business consist mainly in the making of business transactions. Since it is the function of the accounts to record the results of the operations of the business, it is necessary that the relation of business transactions to the accounts be considered.

A business transaction may be defined as an exchange of values. As a result of such exchanges, certain values are received by the business and certain values are parted with by the business. If James Madison sells merchandise for cash, the value he receives is the money given to him by the customer, while the value parted with is the merchandise which he gives to the customer. If Madison purchases merchandise for cash an exactly opposite situation exists, for the value he receives is the merchandise, while the value he parts with is the money. If Madison pays a certain amount for clerk hire, the value he receives is the service rendered by the clerk, while the value parted with is the money paid to the clerk. So in the case of every transaction there is an exchange of equal values and it is the function of accounting to keep a proper record of these values—both those received and those parted with.

In accounting the values received are called *debits* and are recorded on the debit side of the account to which they relate. The values parted with are called *credits* and are recorded on the credit side of the account to which they relate. It can be seen, therefore, that every transaction affects at least two accounts, giving rise to

a debit to one and a credit to the other. This is illustrated below.

If $500.00 worth of merchandise is sold for cash during the month of January, the value received is $500.00 cash, therefore the Cash account will be debited as follows:

Cash

1920 Jan.	31	Sales		500	00						

The value parted with is the merchandise. When merchandise is sold it is termed a sale, hence the Sales account will be credited as follows:

Sales

						1920 Jan.	31	Cash		500	00

If during the same month $200.00 worth of merchandise is purchased for cash, the effect on the business is just the reverse. The value received is the merchandise. When merchandise is purchased it is termed purchases, hence the Purchases account will be debited as follows:

Purchases

1920 Jan.	31	Cash		200	00						

The value parted with is the cash which will be credited to the Cash account. This account will then appear as follows:

Cash

1920 Jan.	31	Sales		500	00	1920 Jan.	31	Purchases		200	00

If $70.00 is paid to a sales clerk, the value received is the services of the clerk. Services used in the operation of a business are termed *expenses*, and since the services of the clerk are used in selling goods they will be termed *selling expenses*. Consequently, the account with Selling Expenses will be debited as in the illustration at the top of page 69.

Selling Expenses

1920 Jan.	31	Cash		70	00						

The value parted with in this transaction is the $70.00 cash; consequently, the Cash account will be credited. This account will then appear as follows:

Cash

1920 Jan.	31	Sales		500	00	1920 Jan.	31	Purchases		200	00
							31	Selling Expenses		70	00

It will be seen later that in some transactions there may be debits to two or more accounts or credits to two or more, or in some cases both. This need not bother the student at this time. The same principles govern the recording of such transactions as those which give rise to but one debit and one credit.

Method of Determining the Debits and Credits to Accounts

Many attempts have been made to give fixed rules for the debiting and crediting of accounts. As suggested above, the determination of the debits and credits resulting from a transaction necessitates that the transaction be analyzed and the value or values received by the business and the value or values parted with by the business be ascertained. After this is done the former are debited to the account to which they pertain and the latter credited in the same manner. If it is desired to express this as a formula it might be stated as follows: *debit, the appropriate account for all values received; and credit, the appropriate account for all values parted with.* The application and illustration of this statement in reference to particular accounts will be given in the chapters immediately following.

Equality of Account Debits and Credits

Since debits and credits arise as a result of business transactions and since business transactions consist of the exchanging of equal values, it necessarily follows that all the debits recorded in the accounts must equal all the credits so recorded. This is what is usually referred to as the equality of debits and credits. In the analysis and recording of transactions the student must always be careful that the debits recorded are equal to the credits recorded. Later, methods of testing the equality of debits and credits will be explained and illustrated.

QUESTIONS FOR CLASS DISCUSSION

1

D. C. Brown is contemplating the purchase of the Jones Retail Store. He requests you to make a Balance Sheet and a Statement of Profit and Loss for this store and submit them to him for his consideration. How would you obtain the information necessary to make these two reports?

2

Your employer requests you to send a statement at the end of each month to each of his customers showing the amount due. How would you proceed to prepare these statements?

3

The cash on hand January 1st is $3,000.00. How would this be shown in the Cash account?

4

During the month of January $10,000.00 cash has been received. How would this be shown in the Cash account? During the same month $9,000.00 cash has been paid. How would this be shown in the Cash account?

5

How would the cash on hand be determined at the end of the month?

6

You take charge of the books for D. C. Brown on December 1, 1919. You are given, in addition to all the accounting records, the Balance Sheet and the Statement of Profit and Loss made on December 31, 1918, by a firm of well-known accountants. On December 31, 1919, you desire to make a Balance Sheet and a Statement of Profit and Loss. In inspecting the ledger accounts you find some with such indefinite titles that you do not know whether they are current or fixed assets. There are some other accounts that you can not determine whether they are expenses or assets. How would you determine what the balances of these accounts represent?

7

James Smith owes the business $100.00 on January 1st. During the month he purchases $300.00 worth of merchandise on account. How would this additional amount which he owes be shown on the ledger?

8

Explain and illustrate the meaning of the terms "debit" and "credit."

9

The following list of account balances is taken from the ledger of W. F. Hupe:

1. Accounts Receivable	$2,000.00
2. Selling Expenses	400.00
3. W. F. Hupe, Proprietor	2,800.00
4. Purchases	5,000.00
5. Administrative Expenses	700.00
6. Sales	5,000.00
7. Inventory	2,000.00
8. Accounts Payable	2,500.00
9. Notes Receivable	400.00
10. Cash	1,200.00
11. Notes Payable	2,300.00
12. Delivery Equipment	900.00

Explain which of these are debit balances and which are credit balances.

10

The following transactions were performed by A. B. King, retail merchant:

1. Bought of Jones & Adams, on account, merchandise, $108.50.
2. Bought of Haines Bros., for cash, merchandise, $70.00
3. Sold to H. P. James, on account, merchandise, $62.00.
4. Paid for rent of store, $40.00.
5. Received for cash sales, $25.00.
6. Paid O. P. Jones, on account, $41.50.
7. Received from E. M. Adams, to apply on account, $28.60.
8. Bought of National Equipment Company, for cash, furniture and fixtures, $60.00.
9. Paid for clerk services, cash, $27.50.
10. Sold to James Field, on account, merchandise, $18.65.

Name the values received and the values parted with in each of the above transactions.

LABORATORY MATERIAL

The purpose of the following exercises is to give practice in the analysis of transactions and the determination of the debits and credits to which they give rise. These exercises are to be prepared on loose sheets of paper ruled as instructed on page 73.

Exercise No. 31

The following transactions were performed by J. O. Hayes, retail clothing merchant, during the month of January:

1. Bought of King Bros., on account, merchandise, $225.00.
2. Paid telephone rent for the month, $5.00.
3. Sold A. K. Meyers, for cash, 1 suit of clothes, $60.00; 1 overcoat, $50.00.
4. Bought of Gartmen & Wagner, on account, merchandise, $85.00.
5. Sold J. T. Rigg, on account, 1 suit of clothes, $44.00.
6. Bought of James M. Madison, for cash, merchandise, $218.00.
8. Sold James W. Baker, on account, 1 suit of clothes, $50.00; 5 shirts at $2.50.
9. Paid Gartmen & Wagner, $85.00, in full for bill purchased on the 3d.
10. Sold Charles Peabody, on account, 2 suits of clothes, $100.00; 1 pair of shoes, $9.00.
11. Bought of Hart, Schaffner & Marx, on account, merchandise, $236.00.
12. Sold J. K. Slack, on account, 1 suit of clothes, $50.00; 1 pair of trousers, $10.00; 4 shirts at $3.00.
13. Received $50.00 from Charles Peabody to apply on account.
20. Received $85.00 from L. S. Lyon for a cash sale.
22. Sold Charles Peabody, on account, 6 shirts at $3.00; 1 hat, $6.00.
24. Paid the City Coal Co. $25.00 for coal to be used in heating building.
27. Paid King Bros. $225.00, in full of account.
29. Received $24.00 from Charles Peabody, in settlement of bill of the 22nd.

Instructions: Draw a line lengthwise through the center of a sheet of note paper. On the left of the line write the debit items and on the right of the line the credit items involved in the above transactions. Merchandise purchased is recorded as "Purchases"; merchandise sold, as "Sales." Indicate the receipt or issuance of an oral promise by writing the name of the person from whom the promise is received or to whom given. The payment of oral promises will be indicated in the same way. The amounts paid for telephone and coal are recorded as "Administrative Expenses." The illustration below shows the method of recording the first three transactions:

Debit Items		Credit Items	
Purchases	$225.00	King Bros.	$225.00
Administrative Expenses	5.00	Cash	5.00
Cash	110.00	Sales	110.00

Exercise No. 32

The following transactions were performed by A. M. Taylor, retail grocer, during the month of March:

1. Bought of J. J. Andrews, on account, merchandise, $120.80.
2. Bought of A. B. Lincoln & Co., on account, merchandise, $284.70.
3. Sold to A. R. Bishop, for cash, merchandise, $180.00.
   Paid rent of store for one month, $30.00.
5. Sold to W. H. Spencer, on account, merchandise, $30.50.
6. Bought of W. E. Atkins, on account, merchandise, $340.70.
7. Sold to E. L. Fairchild, for cash, merchandise, $150.70.
8. Received for cash sales, $80.40.
9. Sold to Harvard Hotel, on account, merchandise, $70.00.
10. Bought of W. M. Oliphant, on account, merchandise, $210.60.
11. Received $30.50 from W. H. Spencer on account.
13. Paid J. J. Andrews, on account, $120.80.
    Paid services of clerk, $15.00.
14. Received for cash sales, $105.60.
15. Sold to E. R. Moses, on account, merchandise, $56.40.

Instructions: Record this exercise in the same manner as Exercise No. 31. Merchandise purchased is recorded as "Purchases"; merchandise sold, as "Sales"; rent paid for store as "Administrative Expense"; services of clerk, as "Selling Expense." Oral promises and payments of oral promises are indicated by the name of the person.

Exercise No. 33

On a sheet of note paper rule "T" accounts to record the transactions in Exercise No. 31. The name of the account is determined from the name given at the left of the amount in the exercise. Record each transaction in regular order. Only the name of the account and the amount are required as shown in the illustration of the first three entries below:

Purchases	
$225.00	

King Bros.	
	$225.00

Administrative Expenses	
$5.00	

Cash	
	$5.00

Cash	
$110.00	

Sales	
	$110.00

Exercise No. 34

Open accounts with the transactions in Exercise No. 32 in the same manner as instructed in Exercise No. 33.

CHAPTER VI

CONSTRUCTION AND INTERPRETATION OF PARTICULAR ACCOUNTS

Information Desired with Reference to Accounts

In the preceding chapter the use of accounts as a means of obtaining the information necessary to make the accounting reports which are needed in the management of a business, and the general principles governing the construction of accounts, have been discussed. It has also been explained how business transactions are analyzed and the values determined by this analysis, debited and credited to their respective accounts. It is now necessary to explain the application of these principles in the construction and interpretation of particular accounts.

In order to comprehend the construction and purpose of an account it is necessary to understand:

1. The object or purpose of the account; that is, the information which it is desired to obtain from the account.
2. The transactions which are to be recorded in it, or the debits and credits which are made to it.
3. What the balance of the account represents and what disposition is made of this balance on the accounting reports.

The following discussion relates to the essential information with reference to the different accounts which would be needed in a simple business like that of James Madison, as shown by his Balance Sheet and Statement of Profit and Loss given in Chapters III and IV. Later, other accounts which are needed in other types of businesses will be studied in the same manner.

Cash Account

The term Cash, as used in accounting, refers to money of all denominations and to any commercial paper which the bank accepts on deposit at face value. The latter includes personal checks, bank drafts, cashier's checks, post office and express money orders, etc.

Such commercial papers will be explained and illustrated in subsequent chapters. The purpose of the Cash account is to show the cash received, the cash paid, and the difference, or the cash on hand. This account, therefore, is affected by every transaction which involves either the receipt or payment of cash.

The debits and credits to the Cash account are as follows:

Cash

DEBIT:	CREDIT:
With cash received. Usually this account is not debited with individual cash items, but for daily, weekly, or monthly totals.	With cash paid. Usually the credits to this account consist of daily, weekly, or monthly totals.

Since it is impossible to pay out more cash than has been received and since in a going business there must be some cash on hand, the debit side of this account is always the larger. This balance shows the cash on hand which may be in the cash drawer or in the bank. It is shown as a current asset on the Balance Sheet.

In order to make a *proof of cash,* the cash in the bank is added to the cash in the drawer or safe and the total compared with the balance of the Cash account to see that they agree exactly. In some businesses such a proof is made daily and in any case should be made at frequent intervals.

Accounts with Debtors

In any business of considerable size it is necessary to sell merchandise on account. In a retail business, such as a grocery store, goods are usually sold on *open* account; that is, oral promises are received in payment for them. In some cases, however, written promises or notes are received either in payment of the merchandise, or later in payment of the oral promises originally received. On the Balance Sheet, the written promises of customers are shown as Notes Receivable and their oral promises are shown as Accounts Receivable. It is necessary, therefore, to have accounts from which the amount of each of these items can be obtained.

Notes Receivable

Since the written promises received from customers are usually not numerous, it is customary to record all notes receivable in one account. The amount due from each customer on notes can be determined at any time bv examining the notes on hand. The date of pay-

ment or other information desired about the note can be determined in the same manner. It is not necessary, therefore, to have a separate account with the notes due from each customer. The purpose of the Notes Receivable account is to show the notes received from others, the amount received from them in payment, and the balance, which is the amount of notes receivable now held by the business. The correctness of this amount can be ascertained by comparing it with the notes on hand.

The debits and credits to the Notes Receivable account are as follows:

Notes Receivable

DEBIT:	CREDIT:
With the face value of all notes received in favor of the business.	With the amount received in payment of notes. With the face value of any note debited to this account when transferred by the business.

Since the business will not receive more in payment of notes than there is due, the debit side of this account is always the larger, except when the account is in balance. The balance is shown on the Balance Sheet as a current asset.

Accounts Receivable

In a retail business the oral promises received from customers are usually quite numerous. Consequently, unlike notes receivable, it is necessary to have a separate account or record with each customer. The keeping of the customer's accounts is usually the most burdensome part of the accounting for a retail business. In a retail grocery store where customers are making purchases almost every day, it can be seen readily that a great amount of detail will be involved in making a proper record of each customer's purchases and payments. Many attempts have been made in the last few years to devise some method which would eliminate some of these details. Of late there has been a tendency among retailers to eliminate the individual ledger account for each customer and to substitute some other form of record. One method is to file a copy of the "sales ticket" issued to the customer, but to make no entry on the ledger for the amount due from the individual customer. At the end of the month a statement is sent to the customer giving the amount due from him as shown by the sales tickets. When the customer remits, the sales tickets for the past month are removed from the file. The total of

the tickets filed under the customer's name at any time, therefore, shows the amount due from him.

The above, as well as other methods, are used in making a record of transactions with customers. The purpose of the present discussion, however, is to explain to the student the *principles* involved in the construction of accounts rather than the *practices* of any particular business. Consequently, a consideration of special methods of recording accounts receivable will be postponed and for the present it will be assumed that a separate ledger account is kept with each customer.

The purpose of an Accounts Receivable, or "Customer's" account, is to show the oral promises received from a customer to whom merchandise has been sold on account, the amount paid by the customer in settlement of the amount due, and the balance, which represents the amount remaining unpaid.

The debits and credits to a Customer's account are as follows:

Accounts Receivable

(Separate accounts with each customer)

DEBIT:	CREDIT:
With the value of merchandise or other property sold to a customer on account.	With cash received from a customer to apply on account. With a note or other property received to apply on account. With any allowance or deduction made to a customer.

Since customers will not pay more than they owe, except by mistake, and the debit side of a Customer's account shows the amount due and the credit side the amount paid, it follows that the debit side will always be the larger, except when the account is in balance. The sum of the balances of all the Customers' accounts is shown on the Balance Sheet as a current asset under the heading of Accounts Receivable.

Accounts with Creditors

When a business sells merchandise on credit it usually finds it necessary to purchase on credit, in which case, it may give either its written or its oral promises in payment of the merchandise purchased. The written promises are shown on the Balance Sheet as Notes Payable and the oral promises as Accounts Payable. Since these items are shown separately on the Balance Sheet it is necessary to have separate accounts with them. Separate records also facilitate the prompt payment of debts due to creditors.

Notes Payable

The notes issued by the business in favor of others are usually not numerous; hence notes payable, like notes receivable, are recorded in one account. As will be explained later, there is sometimes another record besides the ledger account kept with both notes receivable and payable, but in any case only one ledger account is kept with each.

The purpose of the Notes Payable account is to show the notes issued to others by the business, the amount paid in liquidation of these notes, and the balance or the notes still owed. This account is affected by all transactions which increase or decrease the amount of the notes of the business outstanding.

The debits and credits to the Notes Payable account are as follows:

Notes Payable

DEBIT:	CREDIT:
With the amount paid in settlement of notes owed.	With the face value of notes issued by the business.

The credit side of the Notes Payable account is always the larger except when the account is in balance. The balance is shown on the Balance Sheet as a current liability.

Accounts Payable

The accounts payable of a business are usually not so numerous as its accounts receivable. To make a record of them, therefore, is not so burdensome a task. Although in some businesses a separate ledger account is not kept with each creditor, for the purpose of the present discussion and illustrations it is assumed that such accounts are kept.

The purpose of an Accounts Payable or "Creditor's" account is to show the oral promises issued by the business to a creditor from whom merchandise has been purchased on account, the amount paid in settlement thereof, and the balance or the amount still owed to the creditor.

The debits and credits to a Creditor's account are as follows:

Accounts Payable
(Separate accounts with each creditor)

DEBIT:	CREDIT:
With cash paid or notes issued to a creditor to apply on account. With allowances or deductions granted by a creditor which decrease the amount owed.	With the value of merchandise purchased on account.

Since more will not be paid to a creditor than is owed to him, except by mistake, the credit side of this account is always the larger. The sum of the balances of all the creditor's accounts is shown on the Balance Sheet as a current liability under the heading of Accounts Payable.

Accounts with Fixed Assets*

In a previous chapter it is stated that the assets of a business may be divided into two classes: those which are in the form of cash or which will be liquidated in cash within a relatively short time in the regular operations of the business; and those which the owner plans to retain and not to liquidate because they are necessary in the conduct of the business. As previously explained, the former are known as current assets and the latter are known as fixed assets. The construction and interpretation of the accounts with some of the principal current assets, such as cash, accounts receivable, and notes receivable, have been discussed. It is now necessary to examine the construction of accounts with such fixed assets as furniture and fixtures, and delivery equipment.

Furniture and Fixtures

Under this heading is included the property purchased for use in the office of a business, such as desks, typewriters, safes, filing cabinets, book-cases, chairs, tables, etc. In a small business, counters, show cases, etc., may be included under this heading, although in many cases a separate account called Store Fixtures is kept with such property.

The purpose of the Furniture and Fixtures account is to show the *cost* of such equipment purchased, the cost of the equipment disposed of or no longer used in the business, and the balance which represents the cost of the equipment employed in the conduct of the business.

The debits and credits to this account are as follows:

Furniture and Fixtures

DEBIT:	CREDIT:
With the *cost* price of office furniture and fixtures purchased.	With the *cost* price of office furniture and fixtures sold, exchanged, destroyed, or discarded which were previously charged to this account.

* The discussion of depreciation on fixed assets and the accounts necessary to record such depreciation is postponed until Chapter XVI. The reasons for postponing this discussion are the same as those given for not discussing depreciation in connection with the Balance Sheet in Chapter III.

The balance of this account shows the cost value of the furniture and fixtures used in the conduct of the business and is shown as a fixed asset on the Balance Sheet.

Delivery Equipment

The purpose of the account with Delivery Equipment is to show the cost of property purchased for use in delivering goods. This includes cost of horses, wagons, harness, automobiles, or any other conveyances that may be used by the business in delivering goods to customers. Cost of repairs to delivery equipment must not be charged to this account, but to the Delivery Expense account.

The debits and credits to the Delivery Equipment account are as follows:

Delivery Equipment

DEBIT:	CREDIT:
With *cost* price of property purchased for use in delivering goods to customers.	With the *cost* price of any property sold, exchanged, destroyed or discarded which has previously been charged to this account.

The balance of this account shows the cost value of the delivery equipment used in the conduct of the business, and is shown as a fixed asset on the Balance Sheet.

Accounts with the Proprietor

As previously explained, the difference between the total assets invested in the business and the total liabilities of the business represents the proprietorship or the owner's investment in the business. An account is kept with the proprietor to show his original investment, any additions thereto, and any withdrawals therefrom. In addition to the above, at the end of the fiscal period the net profit or loss for the period is carried to the Proprietor's account which then shows his entire financial interest in the business.

The debits and credits to this account are as follows:

Proprietor's Capital Account

DEBIT:	CREDIT:
With debts owed at the beginning of the business if they are assumed by the business. With withdrawals of investment. With the net loss of the fiscal period.	With the original investment of the proprietor. With additional investments. With the net profit of the fiscal period.

The balance of this account, if a credit, shows the net worth of the owner; if a debit, it shows his net insolvency. It is shown

on the Balance Sheet as an addition to the liabilities of the business, the liabilities and proprietorship equaling at all times the total assets.

In addition to the Proprietor's Capital account it is usually necessary to keep a Proprietor's Personal account. The purpose of this account is to keep a record of the amounts which the owner has withdrawn during the year in anticipation of profits or against his salary allowance. It should not include withdrawals which are intended as withdrawals of the original investment, for these items are shown in the Proprietor's Capital account. If the proprietor desires to show his estimated salary on the books, it is debited to Administrative Expense and credited to this account.

The debits and credits to this account are as follows:

Proprietor's Personal Account

DEBIT:	CREDIT:
With amounts drawn against anticipated profits or salary allowance.	With monthly salary allowance.

The balance of this account should be treated as an addition or subtraction to the amount of the Proprietor's Capital account on the Balance Sheet; if a debit balance, it is a deduction from capital, and if a credit balance, an addition to capital.

QUESTIONS FOR CLASS DISCUSSION

1

At the end of the month you desire to prove the correctness of the balance of the Cash account. How would you proceed to make this proof?

2

James Randolph keeps a separate ledger account with each customer. Henry James has made the following purchases during the month of January:

Jan. 1	$10.00
4	14.00
8	6.00
15	4.00
25	13.00

On January 31st James pays $20.00 in cash to apply on account. How would the above items be shown in James' account?

3

On March 1st R. K. Adams owes the business $80.00. In response to a request for payment he sends the business $30.00 in cash and his thirty-day note for $50.00. What ledger entries would be made on receipt of the cash and note from Adams?

4

In your ledger, the account of A. C. Johnson appears as follows:

A. C. Johnson

Jan.	1	$120.00	Jan.	30	$120.00

Is Mr. Johnson a customer or a creditor?

5

Your employer asks you for a statement showing the amount due creditors for merchandise purchased on account. How would you obtain the information necessary to make this statement?

6

Which would usually be the more difficult, to determine the amount due creditors or the amount due from customers? Why?

7

The business gives a note to James Mandell to apply on account. How would this transaction be shown in the accounts?

8

R. A. Hardin purchases for cash delivery equipment valued at $500.00. What entries would be made?

9

James Arnold, a retail merchant, makes an additional investment of $800.00. What entries would be made?

10

The proprietor withdraws for his personal use $50.00 in cash. How would this be entered in the accounts?

LABORATORY MATERIAL

The purpose of the following exercises is to give practice in the recording of transactions affecting the Asset and Liability accounts discussed in this chapter. These exercises are to be prepared on paper ruled similar to Illustration No. 4.

Exercise No. 35

On March 1st, you are employed by A. C. Hodge, retail merchant, as bookkeeper. Mr. Hodge has previously had no complete system of records, so you find it necessary to open up accounts and start new records for him. With his aid you determine the amount of his assets and liabilities and prepare a Balance Sheet, which is as follows:

Cash	$ 500.00	
Notes Receivable	50.00	
Accounts Receivable	2,550.00	
Merchandise Inventory	2,000.00	
Office Furniture	300.00	
Total Assets		$5,400.00
Notes Payable	400.00	
Accounts Payable	2,600.00	
Total Liabilities		3,000.00
Proprietorship		$2,400.00

On ledger paper open the accounts necessary to record the assets, liabilities, and proprietorship of Hodge as of March 1st. Allow eight lines for each account. Show accounts receivable and payable in single accounts.

Exercise No. 36

During the month of March, Hodge performed, among others, the following transactions:

1. Purchased for cash, furniture and fixtures, $200.00.
2. Received cash from customers to apply on account, $200.00.
3. Paid creditors to apply on account, $100.00.
6. Received a note from a customer in payment of amount due, $50.00.

10. Received from a customer in payment of a note, $25.00.
14. Withdrew for private use, $40.00.
17. Purchased for cash a desk for use of bookkeeper, $15.00.
20. Received from customers in payment of account, $200.00.
22. Paid a note due this day, $40.00.
24. Made an additional cash investment of $400.00.
26. Paid creditors to apply on account, $150.00.

Instructions: Make the entries necessary to record the above transactions on the ledger accounts which you prepared for Exercise No. 35.

Exercise No. 37

The following are a part of the transactions performed by D. C. McMillan during the first six months of 1919:

January 1st D. C. McMillan invested the following property in the retail grocery business: cash, $1,000.00; merchandise, $1,250.00; note due from M. H. Wells, $250.00; due on account from R. H. Mays, $225.00, from Robert Simpson, $350.00. He owed the bank a note for $500.00 due April 2nd, and Roberts Bros. on account $250.00.

Feb. 15. Withdrew cash for personal use, $25.00.
Mar. 10. Received from R. H. Mays, $112.50 to apply on account.
April 2. Paid $250.00 cash, on account, of the note due at the bank and renewed the balance for six months.
May 15. Paid Roberts Bros. $100.00 to apply on account.
June 1. Withdrew $200.00 for personal use.
15. Received $112.50 from R. H. Mays in full of account.
30. Received $250.00 from M. H. Wells in payment of note.

Instructions: On loose ledger sheets open the accounts necessary to record the assets, liabilities and proprietorship of D. C. McMillan as of January 1st. Allow six lines for each account. When the two sides of an account are equal, indicate this by drawing a single red line on each side under the amounts only.

Exercise No. 38

The following are a part of the transactions which the bookkeeper for F. B. Moore was required to record during July, August and September:

July 1st F. B. Moore began the contracting business with the following assets and liabilities: cash, $3,000.00; note due him for $400.00; furniture and fixtures valued at $500.00; an account due from Fuller Construction Co. for $5,000.00; tools and equipment valued at $2,000.00 (this will be entered in an account designated as Tools and Equipment; it is of the same nature as the Furniture and Fixtures account). He owes the First National Bank a note for $2,000.00 due August 1st, and R. L. Kennedy & Son $1,500.00 on account.

July 10. Paid R. L. Kennedy & Son $500.00 on account.
20. Purchased furniture and fixtures for cash, $100.00.
Aug. 1. Paid the bank $2,000.00 on account of note.
10. Received $2,000.00 from the Fuller Construction Co. to apply on account.
Sept. 1. Received $200.00 on account of note.
15. Purchased tools and equipment for $1,000.00.

Instructions: Record in the same manner as Exercise No. 37. Allow ten lines for the Proprietor's account and five lines for each of the other accounts.

Exercise No. 39

The following are a part of the transactions which the bookkeeper for O. T. Johnson was required to record during January, February and March, 1920:

January 1st O. T. Johnson began the retail dry goods business with the following assets and liabilities: cash, $2,500.00; merchandise, $1,850.00; note due February 1st, $350.00; note due March 1st, $425.00; accounts receivable, H. B. Boyles, $75.00, C. C. Ruggles, $150.00, A. R. Ross, $175.00; delivery equipment, consisting of an automobile valued at $1,000.00; office equipment, consisting of safe valued at $100.00, typewriter valued at $75.00, desk valued at $35.00, and chairs valued at $15.00. He owes A. F. Doyle $175.00, O. C. Gard $200.00, and First National Bank a note of $1,000.00.

Jan. 15. Withdrew for personal use, $200.00.
20. Paid A. F. Doyle $100.00 to apply on account.

Feb. 1. Received $350.00 for note due today.
5. Withdrew $100.00 for personal use.
15. Received $175.00 from A. R. Ross in full of account.
27. Paid O. C. Gard $100.00 to apply on account.
Mar. 15. Paid the First National Bank $500.00, cash, and gave them a note due in 60 days for $500.00 in settlement for $1,000.00 note due today.
16. Paid cash for a new desk, $50.00.
20. Paid $900.00 cash for a Dodge delivery truck.
24. Withdrew $100.00 for personal use.

Instructions: Follow instructions given under Exercise No. 37. Allow ten lines for the Proprietor's account and the Cash account, and six lines for each of the other accounts.

Exercise No. 40

January 1, 1920, the accounts on the ledger of O. H. Whittle are as follows: cash, debit balance, $2,000.00; delivery equipment, debit balance, $500.00; T. B. Bridges, debit balance, $400.00, J. W. Nixon, debit balance, $600.00; notes receivable, debit balance, $800.00; notes payable, credit balance, $1,000.00; Johnson Bros., credit balance, $1,300.00; O. H. Whittle, Proprietor, credit balance, $2,000.00.

Jan. 5. Gave $500.00 cash in payment of the note due today.
10. Received cash from T. B. Bridges for $200.00 and a note for $200.00 in full of account.
15. Gave Johnson Bros., cash, $300.00, and note for $100.00 to apply on account.
16. O. H. Whittle withdrew cash $200.00 for personal use.
22. Received $300.00 cash from J. W. Nixon to apply on account.
29. Borrowed $500.00 from the bank on note due in 30 days.

Instructions: Record in the same manner as Exercise No. 37. Allow six lines for each account.

CHAPTER VII

CONSTRUCTION AND INTERPRETATION OF PARTICULAR ACCOUNTS—Continued

Accounts with Merchandise

Merchandise is a general term applied to goods bought and sold, such as groceries, dry goods, hardware, etc. In accounting, merchandise bought is termed Purchases, merchandise sold is termed Sales, and the merchandise on hand at the beginning or end of a fiscal period is termed Merchandise Inventory. It is from the purchase and sale of merchandise that the owner of a mercantile business expects to derive his profit, and the majority of the current transactions which such a business performs pertain to purchases and sales.

By referring to the Statement of Profit and Loss given in Chapter IV, it will be seen that sales, purchases, and inventory are shown as separate items; therefore there must be some means by which the amount of each of these items can be obtained at the end of the fiscal period. The amount of the purchases and sales for the period are obtained from the ledger accounts which are kept for the purpose of making a record of them. The inventory of merchandise is obtained usually by making a physical count of the goods in stock, and determining their value at cost price. At the end of the fiscal period, after the amount of the inventory is determined as stated above, it is customary to open an account to record the amount. The present discussion will be confined to a consideration of the accounts with Purchases, Sales, and Inventory. In subsequent chapters the use of other accounts to provide more detailed information with reference to merchandise will be discussed.

The Purchases Account

The object of the Purchases account is to show the cost of goods purchased. Only purchases of goods intended for resale are recorded in this account. Purchases of fixed assets or of miscellaneous supplies, such as pens, paper clips, etc., must be recorded in separate accounts.

The debits and credits to the Purchases account are as follows:

Purchases

DEBIT:	CREDIT:
With the invoice cost of merchandise purchased. With the amounts paid for freight and drayage on merchandise purchased, if a separate account is not kept with these items.	Allowances and deductions are sometimes credited to this account, but where such items occur, it is better to have separate accounts for them as will be explained later.

The balance of this account shows the cost of goods purchased and is shown on the Statement of Profit and Loss as an item of cost of goods sold.

The Sales Account

The purpose of the Sales account is to show the amount of the merchandise sold.

The debits and credits to this account are as follows:

Sales

DEBIT:	CREDIT:
Allowances and deductions are sometimes debited to this account, but where such items occur, it is better to have separate accounts for them as will be explained later.	With the selling price of merchandise sold.

The balance of this account shows the net amount of sales made during the fiscal period and is shown as the principal item of income on the Statement of Profit and Loss.

The Inventory Account

Entries are made in the Inventory account only at the end of the fiscal period. Its construction and use can be explained better, therefore, in connection with the discussion of the summary of operations at the end of the fiscal period; hence a discussion of this account will be postponed until Chapter IX. The Statement of Profit and Loss of James Madison shows that he had an inventory at the beginning of the month of $1,000.00, which would be in his ledger at the close of the month. Since it is the purpose of the illustration given at the end of this chapter to show all the accounts

appearing in the ledger of James Madison on December 31st, it may be explained that his Inventory account will appear as follows:

Inventory

192 Dec.	1			1,000	00				

Accounts with Expenses

It is inevitable that certain expenses will be incurred in the operation of a business and as explained in the discussion of the Statement of Profit and Loss, it is desirable to divide these into at least two groups known as Selling Expenses and Administrative Expenses. If expenses are to be thus subdivided on the Statement of Profit and Loss, it follows logically that there must be two accounts kept with expenses in order to provide the information necessary to make the Statement of Profit and Loss.

Selling Expenses

The purpose of the Selling Expenses account is to show the amount of the expenses incurred which are directly related to the selling of the goods of the business. The nature of such expenses has been explained and illustrated in the discussion of the Statement of Profit and Loss.

The debits and credits to this account are as follows:

Selling Expenses

DEBIT:	CREDIT:
With expenses incurred directly in connection with the sale of merchandise, such as wages of clerks, delivery service, advertising, etc.	With any allowances or returns which decrease the amount debited to this account.

The balance of this account shows the total selling expenses for the period and is shown as an operating expense on the Statement of Profit and Loss.

Administrative Expenses

The purpose of the Administrative Expenses account is to show the cost of administration or management of the business. Under this heading will be included the salaries of the owner, office employees and bookkeeper, the cost of stationery, postage, etc.

The debits and credits to this account are as follows:

Administrative Expenses

DEBIT:	CREDIT:
With all the operating expenses of the business not carried in special accounts.	With any allowances or returns which decrease the amount debited to this account.

The balance of this account is an operating expense and it is so shown on the Statement of Profit and Loss.

Illustration of the Ledger

In the present and the preceding chapters various accounts have been discussed. The accounts given are those necessary to record the information which would form the basis of the Balance Sheet and the Statement of Profit and Loss discussed in Chapters III and IV. In other words, if James Madison desires to have a Balance Sheet and a Statement of Profit and Loss, such as are illustrated in Chapters III and IV, he must maintain the accounts discussed in the last two chapters to record the information which appears on these reports.

As previously explained, the accounts are kept in a book called the Ledger. In order that the student may see how these various accounts would appear in the ledger and in order to illustrate the method of making entries in them, a few simple transactions may be taken. It is not practicable to take sufficient transactions to represent the complete operations of even a small business, but the following are representative of the kind of transactions which might be performed by a retail store:

Dec. 1. James Madison invested $940.00 in cash and $1,000.00 in merchandise in a retail business.

Paid $100.00 for one month's rent of the store and equipment of A. P. Monroe, who is discontinuing his business.

Purchased coal for fuel for the month, $36.73.

2. Purchased on account, from M. L. Rose, merchandise, $240.00.

3. Sold to the following customers on account:

L. S. Lyon, $29.18.

A. C. Hodge, $38.76.

N. W. Barnes, $42.50.

E. R. Lambert, $79.46.

Dec. 6. Purchased for cash, from A. L. Anderson & Co., merchandise, $150.00.

8. Paid clerk for one week's service, $25.00.

9. Sold to the following customers on account:
   - L. S. Lyon, $18.63.
   - A. C. Hodge, $17.50.
   - J. H. Bishop, $91.60.

13. Sold merchandise to J. H. Bishop, on account, $27.92.

15. Received from customers to apply on account:
   - L. S. Lyon, $22.50.
   - A. C. Hodge, $36.86.

16. Paid clerk for one week's service, $25.00.

17. Purchased on account, from G. B. Brown & Co., merchandise, $465.00.

20. Purchased on account, from G. B. Brown & Co., $360.85.

23. Paid clerk for one week's service, $25.00.

24. Purchased for cash from King Wholesale Co., merchandise, $360.00.

25. Withdrew for personal use, $50.00.
   Paid G. B. Brown & Co. $300.00 to apply on account.

27. Sold to the following customers on account:
   - L. S. Lyon, $22.50.
   - A. C. Hodge, $36.86.
   - E. R. Lambert, $17.45.
   - J. H. Bishop, $64.56.
   - N. W. Barnes, $56.45.

29. Paid for advertising in a local newspaper, $30.00.

30. Received a thirty-day note for $27.92 from J. H. Bishop in payment of merchandise purchased December 13th.
   Gave thirty-day note for $60.85 to G. B. Brown & Co., in payment of balance due on merchandise purchased December 20th.

31. Received for sundry cash sales to date, $1,018.37.
   Paid clerk for one week's services, $35.00.
   Purchased store furniture and fixtures for cash, $220.00.
   Purchased delivery equipment for cash, $400.00.
   Paid the following expenses for the month: light, $5.00; telephone, $3.00; water, $1.00; total, $9.00.

When the entries for these transactions are made in the accounts, the ledger of James Madison will appear as in Illustration No. 5, pages 94, 95, 96 and 97.

Cash

Date		Dollars	Cents	Date		Dollars	Cents
192 Dec.	1	940		192 Dec.	1	100	
	15	22	50			36	73
		36	86		6	150	
	31	1018	37		8	25	
					16	25	
					23	25	
					24	360	
					25	50	
						300	
					29	30	
					31	35	
						220	
						400	
						9	

Notes Receivable

Date		Dollars	Cents	Date		Dollars	Cents
192 Dec.	30	27	92				

L. S. Lyon

Date		Dollars	Cents	Date		Dollars	Cents
192 Dec.	3	29	18	192 Dec.	15	22	50
	9	18	63				
	27	22	50				

A. C. Hodge

Date		Dollars	Cents	Date		Dollars	Cents
192 Dec.	3	38	76	192 Dec.	15	36	86
	9	17	50				
	27	36	86				

Illustration No. 5—The Ledger—*Continued*

N. W. Barnes

192 Dec.	3		42 50				
	27		56 45				

E. R. Lambert

192 Dec.	3		79 46				
	27		17 45				

J. W. Bishop

192 Dec.	9		91 60	192 Dec.	30		27 92
	13		27 92				
	27		64 56				

Merchandise Inventory

192 Dec.	1		1000				

Furniture and Fixtures

192 Dec.	31		220				

Delivery Equipment

192 Dec.	31		400				

Notes Payable

				192 Dec.	30		60 85

Illustration No. 5—The Ledger—*Continued*

M. L. Rose

Date		Amount	Date		Amount
			19— Dec.	2	240

G. B. Brown & Co.

Date		Amount	Date		Amount
19— Dec.	25	300	19— Dec.	17	465
	30	60 85		20	360 85

James Madison, Proprietor

Date		Amount	Date		Amount
			19— Dec.	1	1940

James Madison, Personal

Date		Amount	Date		Amount
19— Dec.	25	50			

Sales

Date		Amount	Date		Amount
			19— Dec.	3	29 18
					38 76
					42 50
					79 46
				9	18 63
					17 50
					91 60
				13	27 92
				27	22 50
					36 86
					17 45
					64 56
					56 45
				31	1018 37

Illustration No. 5—The Ledger—*Continued*

Purchases

19—			
Dec.	2	240	
	6	150	
	17	465	
	20	360	85
	24	360	

Selling Expenses

19—			
Dec.	8	25	
	16	25	
	23	25	
	29	30	
	31	35	

Administrative Expenses

19—			
Dec.	1	100	
	1	36	73
	31	9	

Illustration No. 5—The Ledger—*Concluded*

Accounts Receivable and Accounts Payable

In the above illustration of the ledger only five customers' accounts and only two creditors' accounts are given. It is obvious that ordinarily numerous customers would owe Madison and that consequently he would have numerous accounts with customers. For the sake of brevity, however, only five are given here by way of illustration. It would serve no purpose to illustrate the various personal accounts which Madison might have. The few given are typical of them all. The same is true of the accounts with creditors. The few given suffice to illustrate their nature.

Relation of the Ledger to the Balance Sheet and the Statement of Profit and Loss.

With the exception of the merchandise inventory, the ledger given in Illustration No. 5 provides the information necessary to prepare the Balance Sheet given in Chapter III and the Statement of Profit and Loss given in Chapter IV. If a comparison is made of

each item shown on the Balance Sheet and the Statement of Profit and Loss with the balance of the account kept with this item, it will be seen that they are the same with the exception of the inventory. The difference in the amount of the inventory in the two cases is due to the fact that the ledger shows the value of the inventory on December 1st and the Balance Sheet shows the value of the inventory on December 31st. The method of adjusting this difference is explained in Chapter IX. The student should see clearly the relation between the accounts and the accounting reports and should realize the necessity of the former if the latter are to be prepared properly.

Arrangement of Accounts in the Ledger

By referring to the illustration of the ledger of James Madison, it will be seen that the accounts are arranged in the same order in which they appear on the Balance Sheet and the Statement of Profit and Loss. On the Balance Sheet the items are listed as follows: current assets, fixed assets, current liabilities, proprietorship. In the ledger the accounts are arranged in the same order. On the Statement of Profit and Loss the items are as follows: sales, cost of goods sold, expenses. In the ledger the accounts necessary to obtain the amount of each of these items are arranged accordingly.

The accounts in the ledger should always be arranged in the same order in which they appear on the Balance Sheet and the Statement of Profit and Loss. This arrangement facilitates the making of the reports and the later comparison of the reports with the accounts.

Summary

In Chapter V it has been explained that the primary function of the account is to provide a classified and summarized record of the information which the owner needs in the management of his business. Since he needs information of various kinds it is necessary to have various accounts in order to obtain this information. In the preceding discussion the construction and interpretation of the particular accounts which are needed in a retail mercantile business have been discussed. Although these accounts have been discussed with particular reference to their use in a retail mercantile business, the same principles would govern their use in other lines of business, for they are accounts which are common with a few exceptions to all businesses. If the student understands the principles governing the use and construction of these accounts he will have little difficulty in applying these same principles to the accounts which will be discussed in subsequent chapters.

QUESTIONS FOR CLASS DISCUSSION

1

On January 1st, James Arnold had $3,000.00 worth of merchandise on hand. During the month he purchased $6,000.00 worth of merchandise and sold $7,000.00. How would these facts be recorded in the ledger accounts?

2

If, on January 31st, Arnold desires to know the gross profit made from the sale of merchandise during the month, what information in addition to that given in the preceding question must he have? How would this be obtained?

3

A. B. Hill, retail merchant, purchases at one time $500.00 worth of goods intended for resale, a desk for use in his office for $50.00, and some stationery, pens and paper clips for $5.00. How would these items be recorded in his accounts?

4

Mr. Hill sells one-half of the goods which he purchased, and sells his old desk, which has been replaced by the new one. Both sales are for cash. How would he record these transactions in his accounts?

5

Explain and illustrate how the operating expenses of a mercantile business may be classified.

6

W. D. Wolfe makes the following cash payments:

1. Wages of Sales Clerk	$25.00
2. Stationery and Postage	3.50
3. Wages of Bookkeeper	24.00
4. Advertising in Local Paper	3.70
5. Wages of Delivery Clerk	18.00
6. Rent of Store	40.00

Explain what accounts would be debited for each of the above items.

7

Explain how the balance of each of the following accounts is shown on the Statement of Profit and Loss:

1. Purchases.
2. Sales.
3. Inventory.
4. Selling Expenses.
5. Administrative Expenses.

8

W. H. Spencer is the proprietor of a retail dry goods store. State five different expenses he might incur which would be classified as selling expenses.

9

State five expenses of Mr. Spencer which would be classified as administrative expenses.

10

Explain the order in which accounts are arranged in the ledger. State the reason for this order of arrangement.

LABORATORY MATERIAL

The purpose of the following exercises is to give practice in the recording of transactions affecting the accounts discussed in the two preceding chapters. These exercises are to be prepared on loose-leaf ledger paper.

Exercise No. 41

The following represent cash transactions of H. L. Orr, made during the month of February:

Feb. 1. Invested $3,000.00.
2. Paid $1,800.00 for merchandise.
3. Paid rent, $40.00; paid office salaries, $30.00.
Paid $60.00 for scales; paid $400.00 for delivery truck.
5. Gave the Hepler Safe Co. check for $150.00 for safe.
8. Received for cash sales, $170.00; paid driver, $15.00.
10. Paid telephone rent, $8.00; received for merchandise from Gladstone Hotel, $150.00.
13. Received for cash sales, $95.00; paid $25.00 for office desk.
16. Paid $225.00 for merchandise; received for cash sales, $150.00.
19. Gave Jones Bros. a check in payment of merchandise, $67.00.
20. Received for cash sales, $150.00.
22. Paid clerk hire, $40.00.
26. Received for cash sales, $120.00; paid taxes, $80.00.

Instructions: On ledger paper open the accounts necessary to record the above transactions and show the debits and credits to these accounts. Allow fifteen lines for the Cash account, eight lines for the Sales account, and five lines for each of the other accounts.

Exercise No. 42

Oct. 1. E. B. Moore invested $1,000.00 in the office supplies business.
2. Bought from A. C. Johnson, on account, merchandise, $317.65.
3. Purchased a typewriter for $100.00 and a desk for $25.00.

Oct. 5. Received $75.50 for sundry cash sales.

6. Paid rent of store, $50.00.

7. Bought for cash, merchandise, $125.75.

12. Sold A. C. Johnson, on account, merchandise, $75.00.

15. Paid clerk hire, $25.00.

Instructions: Follow instructions given under Exercise No. 41. Allow five lines for each account.

Exercise No. 43

Nov. 1. D. C. Brown invested $2,000.00 in the musical instruments business.

2. Paid rent, $50.00.

3. Purchased horse and wagon for cash, $200.00.
Bought of John Church Co., on account, merchandise, $418.65.

4. Sold M. E. McMahon, on account, one Victrola, $250.00

5. Bought of The Aeolian Co., for cash, merchandise, $614.65.

7. Sold B. L. McDaniel, on account, one accordion, $15.00.

9. Paid clerk hire, $25.00.

11. Bought of Baldwin Piano Co., on account, merchandise, $278.50.

12. Cash sales to date, $175.50.

16. Paid John Church Co., in full of account, $418.65.

17. Purchased a showcase for cash, $40.00.

18. Received from M. E. McMahon, $100.00 to apply on account.

23. Paid Baldwin Piano Co. $100.00, to apply on account.

25. Sold W. O. Crosswhite, on account, 1 Star Piano, $450.00.

26. Cash sales to date, $280.65.

31. Paid clerk hire, $40.00.

Instructions: Follow instructions given under Exercise No. 41. Allow ten lines for the Cash account and six lines for each of the other accounts.

Exercise No. 44

May 1. A. R. King invests $2,000.00 in the retail clothing business.
Bought of David Bros., on account, merchandise, $216.87.

May 2. Bought of Becker Clothing Co., on account, merchandise, $75.42.
3. Sold A. C. Brown, on account, 1 suit of clothes, $44.00.
4. Bought of Burkhardt Bros. Co., for cash, merchandise, $218.72.
Purchased a used auto truck for $400.00 cash.
5. Sold for cash, 1 suit of clothes, $60.00; 1 overcoat, $50.00.
6. Sold A. R. Cohen, on account, 1 suit of clothes, $50.00; 5 shirts at $2.50.
8. Paid Becker Clothing Co., $75.42, in full for bill purchased on the 2nd.
Sold Charles Horne, on account, 1 suit of clothes, $50.00; 1 vest, $10.00.
9. Bought of Burkhardt Bros. Co., on account, merchandise, $167.92.
10. A. R. King withdrew $50.00 for personal use.
Sold A. C. Brown, on account, 1 suit of clothes, $50.00; 1 pair pants, $15.00; 4 shirts at $2.50; 6 shirts at $2.00; 3 pair socks at 50c.
11. Received $50.00 from Charles Horne, on account.
12. Purchased a safe for cash, $100.00.
Bought of Becker Clothing Co., on account, merchandise, $84.75.
13. Paid $10.00, telephone rent for the month.
Received $62.50 from A. R. Cohen in payment for bill sold the 6th.
15. Bought of David Bros., on account, merchandise, $203.18.
Paid rent, $50.00, and clerk hire, $75.00.

Instructions: Follow instructions given under Exercise No. 41. Allow ten lines for the accounts with Cash, Purchases and Sales, and five lines for each of the other accounts.

Exercise No. 45

The following transactions are to be recorded in the ledger. Be careful to make the proper debit and credit for each transaction. On ledger paper open the accounts given in the list at the top of page 104, allowing the space specified. Divide the pages with double lines as in Illustration No. 5.

Cash, fifteen lines; Notes Receivable, A. K. Langley, Harvard Hotel, Gladstone Hotel, C. M. Johnson, G. G. Munn, L. S. Lyon, R. E. Taylor, A. P. Monroe, Merchandise Inventory, Furniture and Fixtures, Wallace & Co., English Bros., Meyer & Hassler, Cloverdale Creamery, J. Arthur Kinley, Cassidy Bros., N. W. Barnes, Proprietor, and N. W. Barnes, Personal, each six lines; Sales, twenty lines; Purchases, fifteen lines; Selling Expenses and Administrative Expenses, each six lines.

May 1. N. W. Barnes invested $2,000.00 in the retail grocery business.

2. Bought of Wallace & Company, on account, merchandise, $77.30.

3. Bought of English Brothers, on account, merchandise, $134.05.

4. Paid $20.00 cash, city and state license for one year. (Debit Selling Expenses.)

5. Sold A. K. Langley, on account, merchandise, $14.25.
Bought of J. Arthur Kinley & Company, for cash, flour per invoice 7 of this date, $192.00.

6. Received $30.00 for sundry cash sales to date.
Paid Wallace & Company in full of account, $77.30.

8. Sold the Harvard Hotel, on account, merchandise, $56.85.

9. Received $10.00 from A. K. Langley to apply as part payment of the amount he owes.

10. Bought of Meyer & Hassler, on account, merchandise, $228.60.

11. Sold A. K. Langley, on account, merchandise, $44.25.

12. Received from the Harvard Hotel $30.00 in part payment of the bill sold them on the 8th.

13. Received $40.00 for sundry cash sales to date.
Paid English Brothers $100.00 to apply on account.
Sold A. P. Monroe, on account, merchandise, $52.40.

15. Bought of Wallace & Company, on account, merchandise, $246.00.

16. Sold Gladstone Hotel, on account, merchandise, $49.40.

17. Bought of Clover Dale Creamery, on 20 days' account, merchandise, $28.00.

18. Received of A. P. Monroe $35.00 to apply on account.
Paid A. P. King $100.00 for office furniture.

19. Sold C. M. Johnson, on account, merchandise, $42.30.

May 20. Paid English Brothers the balance due them.
Received $50.00 for sundry cash sales to date.
22. Sold G. G. Munn, on account, merchandise, $24.05.
23. Bought of J. Arthur Kinley & Company, on account, merchandise, $197.10.
24. Received from the Harvard Hotel, in part payment of their account, $15.00.
Paid Meyer & Hassler $185.00 on account.
25. Sold Gladstone Hotel, on account, merchandise, $80.35.
26. Received $4.25 from A. K. Langley, in payment balance due on bill of May 5th.
Sold L. S. Lyon, on account, merchandise, $78.25.
27. Sold R. E. Taylor, on account, merchandise, $42.25.
Received $42.50 for sundry cash sales.
Bought of Cassidy Brothers, on account, merchandise, $172.75.
29. Received $50.00 from L. S. Lyon, to apply on account.
30. Paid Wallace & Company $150.00, to apply on account.
31. Paid bookkeeper's salary, $50.00; rent, $40.00.
Received note for $42.30 from C. M. Johnson, in full of account.
Barnes withdrew for personal use $30.00.

Instructions: Follow instructions given at the beginning of this exercise. When approved, preserve this exercise for further instructions.

CHAPTER VIII

THE TRIAL BALANCE

Purpose of the Trial Balance

In Chapters V, VI and VII the account has been discussed as a means of making a current record of transactions. As previously explained, a transaction consists of an exchange of equal values. The values received by the business are termed debits and the values parted with are termed credits. To record a transaction involves its analysis in order to determine the debits and credits to which it gives rise, and the recording of these debits and credits in the proper accounts.

Since the debits arising from each transaction are equal to the credits arising from the same transaction, it follows that if a correct record of all transactions is made in the accounts, the total of the debits arising from these transactions will equal the total of the credits arising therefrom. In other words, the debits in the ledger should equal or *balance* the credits. In order to see if this is true, a test of their equality is made at least at the end of each fiscal period and usually at the end of each month. Such a test is known as a Trial Balance. The purpose of the present chapter is to explain and illustrate how the Trial Balance is made.

Method of Taking a Trial Balance

As previously stated, the primary purpose of the Trial Balance is to prove the equality of the debits and credits recorded in the ledger. In many of the accounts there are several debits and several credits and one method of proving the equality of the debits and credits would be to list all the debits recorded in all the accounts and all the credits recorded in all the accounts and compare the totals obtained from the addition of each. The Trial Balance is a report, however, and the purpose of a report is to give summarized information; hence such a procedure would be unsatisfactory. It is the practice, therefore, before making a Trial Balance, to go through the ledger and add the debits and credits of each account and place the total of each in small pencil figures just below the last

debit or credit item recorded in the account. The method of doing this is illustrated in the Cash account given in the illustration below.

Cash

1920					1920					
Jan.	1		250	86	Jan.	2			42	65
	2		110	24		4			78	65
	7		86	72		8			97	42
	12		43	54		13			114	74
	15		18	75		17			89	63
	22		43	65		22			78	59
	27		18	68		27			25	64
	29		126	75		29			189	76
	30		246	72		30			175	42
	31		27	82					892	50
			973	73						

After the totals of the debits and credits of each account are obtained the Trial Balance may be made in two ways. The first method is to list all the debit totals and all the credit totals and after adding each compare the total of the former with the total of the latter. The second method is to ascertain the difference between the total of the debits of each account and the total of the credits of the same account and obtain thereby the debit or credit balance of the account. Then the debit and credit balances of all the accounts are listed on the Trial Balance, and if the sum of the debit balances equals the sum of the credit balances it is evident that the debits and credits of the ledger are equal. Either method serves equally well to test the equality of debits and credits. The latter method is more frequently used because it makes the Trial Balance simpler and more usable. Both methods are illustrated below.

Illustration of the Trial Balance

In order to illustrate how the Trial Balance is made, it may be assumed that a Trial Balance is to be taken from the following simple ledger:

Cash

1920					1920					
Jan.	1		3,800	00	Jan.	2			300	00
	11		250	50		3			3,000	00
	22		10	50		4			25	00
	22		12	00		25			600	00
	27		200	00		30			100	00
	27		16	00		31			42	00
			4,289	00					4,067	00

A. B. Hill

1920					1920				
Jan.	8			10 50	Jan.	22			10 50
	16			13 00					
				23 50					

P. B. S. Peters

1920					1920				
Jan.	8			12 00	Jan.	22			12 00
	16			20 00					
				32 00					

R. L. Long

1920									
Jan.	8			18 00					

A. M. King

1920					1920				
Jan.	16			16 00	Jan.	27			16 00
	28			14 00					
				30 00					

Furniture and Fixtures

1920									
Jan.	2			300 00					

Cincinnati Milling Company

1920					1920				
Jan.	25			600 00	Jan.	5			600 00

Quaker Oats Company

					1920				
					Jan.	14			200 00

St. Louis Wholesale Company

1920					1920				
Jan.	30			100 00	Jan.	20			250 00

D. D. Dwyer, Proprietor

					1920				
					Jan.	1			3,800 00

Sales

						1920					
						Jan.	8			10	50
							8			12	00
							8			18	00
							11			250	50
							16			13	00
							16			16	00
							16			20	00
							27			200	00
							28			14	00
										554	00

Purchases

1920											
Jan.	3			3,000	00						
	5			600	00						
	14			200	00						
	20			250	00						
				4,050	00						

Selling Expenses

1920											
Jan.	4			25	00						

Administrative Expenses

1920											
Jan.	31			42	00						

First Method

If the total debits and total credits of each account are to be shown in the Trial Balance they would be as follows:

D. D. Dwyer
Trial Balance, January 31, 1920

Cash	4,289	00	4,067	00
A. B. Hill	23	50	10	50
P. B. S. Peters	32	00	12	00
R. L. Long	18	00		
A. M. King	30	00	16	00
Furniture and Fixtures	300	00		
Cincinnati Milling Company	600	00	600	00
Quaker Oats Company			200	00
St. Louis Wholesale Company	100	00	250	00
D. D. Dwyer, Proprietor			3,800	00
Sales			554	00
Purchases	4,050	00		
Selling Expenses	25	00		
Administrative Expenses	42	00		
	9,509	50	9,509	50

It is not customary to include in the Trial Balance accounts like that of the Cincinnati Milling Company, where the debits and credits are equal. This account is included in the above illustration in order that the student may trace each ledger account to the Trial Balance.

Since the Trial Balance shows that the total of all the debits in the ledger is equal to the total of all the credits, the ledger is said to be in balance.

Second Method

In the second method, only the balance of each account is shown on the Trial Balance. In order that the student may see the relation of these two methods and how each proves the equality of the ledger debits and credits, the following illustration may be taken:

D. D. Dwyer
Trial Balance, January 31, 1920

Cash	4,289	00	4,067	00	222	00		
A. B. Hill	23	50	10	50	13	00		
P. B. S. Peters	32	00	12	00	20	00		
R. L. Long	18	00			18	00		
A. M. King	30	00	16	00	14	00		
Furniture and Fixtures	300	00			300	00		
Cincinnati Milling Co.	600	00	600	00				
Quaker Oats Company			200	00			200	00
St. Louis Wholesale Co.	100	00	250	00			150	00
D. D. Dwyer, Proprietor			3,800	00			3,800	00
Sales			554	00			554	00
Purchases	4,050	00			4,050	00		
Selling Expenses	25	00			25	00		
Administrative Expenses	42	00			42	00		
	9,509	50	9,509	50	4,704	00	4,704	00

It will be seen that in the first two columns the total debits and credits of each account are given, the same as in the illustration of the Trial Balance shown on the preceding page. In the last two columns the debit or credit balance of each account is shown. This is obtained by subtracting the figures in the first two columns whenever the account shows both a debit and a credit total. When the account shows only a debit or a credit total this total is carried over as the debit or credit balance of the account. By referring to the totals of the last two columns it will be seen that the equality of the debits and credits is shown in the same way as in the first two columns.

Trial Balance of the Ledger of James Madison

In Chapter VII the ledger of James Madison is given. If a Trial Balance is made of this ledger it will appear as follows:

James Madison
Trial Balance, December 31, 192

1	Cash	252			
1	Notes Receivable	27	92		
1	L. S. Lyon	47	81		
1	A. C. Hodge	56	26		
2	N. W. Barnes	98	95		
2	E. R. Lambert	96	91		
2	J. H. Bishop	156	16		
2	Merchandise Inventory	1000			
2	Furniture & Fixtures	220			
2	Delivery Equipment	400			
2	Notes Payable			60	85
3	M. L. Rose			240	
3	G. B. Brown & Co.			465	
3	James Madison, Proprietor			1940	
3	James Madison Personal	50			
3	Sales			1561	74
4	Purchases	1575	85		
4	Selling Expenses	140			
4	Administrative Expenses	145	73		
		4267	59	4267	59

Illustration No. 6—Trial Balance

The student should compare the Trial Balance given in Illustration No. 6 with the ledger given in Illustration No. 5 on pages 94-97. The numbers at the left of the names of the accounts are the pages on which the accounts appear in the ledger.

QUESTIONS FOR CLASS DISCUSSION

1

If all the transactions of a business for a certain period of time are properly recorded in the ledger, what relation should exist between the debits and credits of the ledger?

2

How may this relationship be tested?

3

What work should be performed with reference to the ledger accounts preliminary to the Trial Balance?

4

Explain the two methods which may be employed in taking a Trial Balance.

5

The account of H. L. White appears as follows:

H. L. White

Jan.	5			422	50	Jan.	15			422	50

How would this account be treated when the Trial Balance is taken on January 31st?

6

The account of Fern M. Jones appears as follows:

Fern M. Jones

Mar.	1			56	00	Mar.	10			56	00
	13			42	00						

Explain two ways in which this account may appear on the Trial Balance.

7

The Trial Balance of the Atkins Mercantile Co. on December 31, 1919, shows that the debits and credits of the ledger of the company are equal. Statements are sent to customers showing the amount of their indebtedness to the company, and several of them claim

that the statements are incorrect. Explain how it may be possible for a Trial Balance to be obtained and the statements be incorrect.

8

How would you advise the bookkeeper of the Atkins Mercantile Co. to proceed in order to find the errors in the customers' accounts?

9

Does the Trial Balance serve any purpose other than as a means of testing the equality of the ledger debits and credits?

10

In what order should the accounts appear on the Trial Balance?

LABORATORY MATERIAL

The purpose of the following exercises is to give practice in preparing the Trial Balance as discussed and illustrated in this chapter. These exercises are to be prepared on paper ruled similar to Illustration No. 6. The Statements of Profit and Loss and the Balance Sheets required are to be completed as previously instructed.

Exercise No. 46

The ledger of D. D. Sells, on June 30th, after one month's operations, appears as follows:

Cash

June	1			2,000 00	June	1			200 00
	8			500 00		2			2,000 00
	15			600 00		30			100 00
	22			700 00		30			200 00
	29			780 00		30			50 00
	30			80 00					

Notes Receivable

June	20			40 00					

E. C. Cline

June	3			40 00	June	20			40 00
	17			80 00					

E. H. White

June	4			80 00	June	30			80 00
	20			100 00					

E. R. Taylor

June	5			60 00					

A. C. Hodge

June	21			62 00					

Mdse. Inventory

Furniture and Fixtures

June	1			200	00						

Notes Payable

						June	18			700	00

A. R. Long

						June	6			300	00

D. O. King

						June	10			400	00

A. M. Anderson

June	18			700	00	June	18			700	00
						June	20			500	00

D. D. Sells, Proprietor

						June	1			2,000	00

D. D. Sells, Personal

June	30			50	00						

Sales

						June	3			40	00
							4			80	00
							5			60	00
							8			500	00
							15			600	00
							17			80	00
							20			100	00
							21			62	00
							22			700	00
							29			780	00

Purchases

June	2			2 000	00						
	6			300	00						
	10			400	00						
	18			700	00						
	20			500	00						

Selling Expenses

June	30			200	00						

Administrative Expenses

June	30			100	00						

Profit and Loss

Instructions: 1. Copy the above ledger on loose sheets of ledger paper, placing four accounts on each page.

2. Take a Trial Balance of the ledger you have copied, showing only the debit or credit balance of each account.

Exercise No. 47

On June 30th, Sells has a merchandise inventory of $1,800.00. Prepare a Balance Sheet for Sells as of June 30th, and a Statement of Profit and Loss showing result of operations for June.

Preserve this exercise for future use.

Exercise No. 48

Prepare a Trial Balance of the ledger of N. W. Barnes as prepared in Exercise No. 45.

Exercise No. 49

The inventory of Barnes on May 31st is $1,000.00. Make a Balance Sheet for Barnes as of May 31st, and a Statement of Profit and Loss showing results of operations for May.

Preserve this exercise for future use.

Exercise No. 50

The Trial Balance of James Madison is given in Illustration No. 6. Madison's inventory of merchandise of December 31st is $1,450.00. Prepare a Balance Sheet and a Statement of Profit and Loss from the Trial Balance of Madison.

CHAPTER IX

THE ADJUSTING AND CLOSING ENTRIES

A. ADJUSTING ENTRIES

Need of Adjusting Entries

A current record of the transactions which a business performs is made in the accounts. The making of this record involves: first, the analysis of the transactions to determine the debits and credits arising therefrom, and, second, the recording of these debits and credits in the appropriate accounts. The record made at the time the transaction is performed shows the effect of the transaction on the financial condition of the business. This effect on the financial condition is indicated by making certain changes in the items which will later appear on the accounting reports. For instance, if cash is paid for a service which is to be treated as an expense, the change in the financial condition of the business which is produced by this transaction is shown by subtracting the cash paid in the Cash account and adding the service received in some Expense account. So in the case of every transaction its effect on the financial condition of the business is reflected in the accounts.

There are, however, some changes in financial condition which are not the direct result of a transaction or which can not be recorded conveniently at the time they take place. To illustrate, at the beginning of the fiscal period there is certain merchandise on hand. Its amount, expressed in monetary units, is shown in a Merchandise Inventory account. During the year additional merchandise is purchased, and merchandise is sold. Consequently the amount of merchandise on hand at any time during the year will in all probability be different from the amount shown in the records. In most mercantile firms it is not practicable to show in the records the daily changes in the value of the inventory. The usual method is to wait until the end of the fiscal period and then determine by count the amount and value of merchandise on

hand. The amount of the inventory as shown in the reports prepared at the end of the period must be that of the inventory taken at closing time. Therefore an entry must be made to correct the balance of the Inventory account so that it will show the amount of the new inventory instead of the old inventory balance.

To take another simple illustration, the fixed assets of the business are decreasing in value constantly, due to their use in the business. This decrease in value, however, can not be recorded in the accounts day by day as it takes place. At the end of the fiscal period, therefore, the amount of the depreciation on fixed assets must be estimated and entries made which will show the effect of such depreciation on the financial condition of the business.*

The foregoing are samples of numerous changes in the financial condition of the business which take place during the fiscal period, but which can not be conveniently recorded until the end of the fiscal period. The entries made at the end of the fiscal period to give effect to such changes are known as *adjusting* entries. Their purpose is to adjust the accounts so that these will reflect the true financial condition of the business and will agree with the accounting reports. In the present chapter such adjusting entries will be considered as would be used in a simple business like that of James Madison.

Merchandise Inventory

As previously stated, it is customary in mercantile firms to ascertain the amount of the merchandise inventory by taking an actual count of the goods on hand at the end of the fiscal period. These goods are then priced at the cost price, unless the market price is lower than cost, in which case conservative practice dictates that they should be evaluated at the lower price. The value of the inventory thus obtained is recorded in the account with merchandise inventory.

The purpose of the Inventory account is, therefore, to show the amount of salable merchandise on hand at the end of the fiscal period valued at cost or market price, whichever is the lower.

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* For the reasons given in Chapter III the discussion with reference to depreciation on fixed assets is postponed until Chapter XVI. Consequently, the adjusting entries with reference to depreciation are also postponed until that chapter.

The debits and credits to this account are as follows:

Merchandise Inventory

DEBIT:	CREDIT:
At the end of each fiscal period with the amount of the inventory taken at the end of that period. The corresponding credit is to purchases or some other account showing the cost of the goods sold.	At the end of each fiscal period with the amount of the inventory at the beginning of the period. (This will be the amount of the debit balance in the account previous to the entry of the new inventory.) The corresponding debit will be to the purchases account or some other account designed to show the cost of goods sold.

The balance of the Inventory account is always a debit balance, since it is an asset account and shows the amount of the inventory at the end of the last fiscal period for which reports were prepared.

Illustration of the Inventory Account and the Adjustments

The nature of the entries necessary to make the adjustments required to show the inventory changes may be made clearer to the student by showing how they affect the accounts involved. James Madison's inventory for December is $1,000.00, and that is the debit balance which would appear in the account at the time the preliminary Trial Balance is taken on December 31st. The account before any adjusting entry is made appears as follows:

Merchandise Inventory

192 Jan.	1			1000	00						

It was seen that on the Statement of Profit and Loss the inventory at the beginning of the period is added to the amount of the purchases for the period as part of the process of obtaining the cost of goods sold. In order to bring the ledger into accord with this statement, the amount of this old inventory will be added to the purchases as shown in the Purchases account. This is accomplished by debiting the Purchases account with the amount of the old inventory and crediting the inventory with that amount. This has the effect of subtracting from the Inventory account the amount of the old balance, and of adding it to the amount of purchases, thus showing the total amount of goods which were available during the period and which could possibly have been

sold. The two accounts affected by this entry will appear as follows:

Merchandise Inventorv

192 Jan.	1			1000	00	192 Dec.	31	Purchases		1000	00

Purchases

192 Dec.	2			240	00						
	6			150	00						
	17			465	00						
	20			360	85						
	24			360	00						
	31	Inventory		1000	00						

By reference to the Inventory account it will be seen that the debits and credits in that account are now equal. When this is true of any account, the account is said to be in *balance.* This may be indicated by totaling the two sides, writing both totals on the line where the total of the longer side falls, and drawing double lines beneath the two totals. These double lines signify that there is equality between the two sides to that point, and that all above the double lines may be ignored in the future. In this account there is only one item on each side, and the fact that the account is in balance may be indicated as follows:

Merchandise Inventory

192 Jan.	1			1000	00	192 Dec.	31	Purchases		1000	00

In the Statement of Profit and Loss it was seen that the amount of the inventory on hand at the end of the period was deducted from the sum of the inventory at the beginning and the purchases for the period, in order to arrive at the cost of the goods sold. This deduction can be shown in the ledger and the Inventory account be made to show the amount of the newly ascertained inventory by an entry debiting the Inventory account and crediting Purchases account. Such an entry, as will appear from the illustration, has the double effect of deducting the amount from purchases and of setting up in the ledger the amount of the inventory now on hand. The following illustration shows how these accounts will then appear:

Merchandise Inventory

192 Jan.	1			1000	00	192 Dec.	31			1000	00
Dec.	31			1450	00						

Purchases

192					192					
Dec.	2			240 00	Dec.	31	Inventory			1450 00
	6			150 00						
	17			465 00						
	20			360 85						
	24			360 00						
	31	Inventory		1000 00						

B. CLOSING ENTRIES

Purpose of the Closing Entries

After the entries discussed in the preceding paragraph have been made, the accounts of James Madison are adjusted so that they agree with the Balance Sheet and Statement of Profit and Loss. If a Trial Balance were taken at this time each item shown thereon would agree with the same item on the Balance Sheet and the Statement of Profit and Loss. Although the individual accounts agree with the individual items which appear on the reports, one more step is necessary before there is complete agreement between the two. The Statement of Profit and Loss shows a summary of the income and expenses with the resulting net profit. In accounting practice it is customary and desirable that the same summary be shown on the ledger. In order that such a summary may be shown it is necessary that certain ledger accounts be "closed." The entries by which these accounts are closed and the ledger summary made are termed Closing Entries. It is the purpose of the present chapter to explain and illustrate the entries necessary to make a summary of the ledger of James Madison as shown in Chapter VII.

Gross Profit on Sales

In making a summary of the ledger accounts with income and expenses, the simpler method is to follow the same order that is followed on the Statement of Profit and Loss. By reference to the Statement of Profit and Loss, it will be seen that the cost of goods sold is subtracted from sales in order to obtain the gross profit on sales. The cost of goods sold is obtained by adding the purchases to the beginning inventory and subtracting the ending inventory. In making the adjusting entries in the preceding chapter, the beginning inventory is debited to the Purchases account and the ending inventory is credited to this account. After these entries are made the balance of this account shows the cost of goods sold, which must agree with the cost of goods sold as shown on the Statement

of Profit and Loss. Since the cost of goods sold is already shown on the ledger, it is only necessary to show this as a subtraction from sales, and the Gross Profit on Sales will be shown on the ledger the same as on the Statement of Profit and Loss. The sales are shown on the credit side of the Sales account; hence, if the cost of goods sold is shown on the debit side of the same account its subtraction from sales will be indicated. This is accomplished by debiting the Sales account and crediting the Purchases account for $1,125.85.

After making this entry, the Purchases and Sales accounts appear as follows:

Purchases

192						192				
Dec.	2			240	00	Dec.	31	Inventory	1,450	00
	6			150	00		31	Cost of Goods		
	17			465	00			Sold	1,125	85
	20			360	85					
	24			360	00					
	31	Inventory		1,000	00					

Sales

192						192				
Dec.	31	Cost of Goods				Dec.	3		29	18
		Sold		1,125	85				38	76
									42	50
									79	46
							9		18	63
									17	50
									91	60
							13		27	92
							27		22	50
									36	86
									17	45
									64	56
									56	45
							31		1,018	37

Profit and Loss Account

The balance of the Sales account will now show the gross profit on sales, which is $435.89. By referring to the Statement of Profit and Loss, it will be seen that the selling and administrative expenses of the business are subtracted from the gross profit on sales to determine the net operating profit. In order to show the same result on the ledger, it is necessary to set up an account, usually called the Profit and Loss account, to which the operating expenses are debited and the operating income credited.

As indicated above, the purpose of the Profit and Loss account is to offset operating expenses against operating income, with the

resulting balance which shows the net operating profit. This account is often spoken of as a Summary account, since it is used to summarize the results of the operations of the period. It is not opened until the end of the fiscal period and is closed as soon as it has served its purpose as explained below. Consequently no transactions during the period should be recorded in it.

The debits and credits to the Profit and Loss account are as follows:

Profit and Loss

DEBIT:	CREDIT:
With the balance of each account which shows an operating expense.	With the balance of each account which shows an operating income.

As suggested in the discussion of the Statement of Profit and Loss, there may be non-operating expenses and non-operating incomes, and frequently both of these are shown in the Profit and Loss account. Such items, however, should be shown in a separate section of the Profit and Loss account, just as they are shown in a separate section of the Statement of Profit and Loss. The recording and reporting of these items will be considered later, but for the present the Profit and Loss account may be considered as a summary of operating income and expense only.

The balance of the Profit and Loss account, if a credit, shows the net profit for the fiscal period and is transferred to the credit side of the Proprietor's account. If it is a debit, it shows the net loss for the period and is transferred to the debit side of the Proprietor's account. The balance of the Profit and Loss account, that is, the amount transferred to the Proprietor's account, must agree with the net profit or net loss as shown by the Statement of Profit and Loss.

Net Operating Profit

The gross profit on sales, as shown by the Sales account of James Madison, is $435.89, and this is transferred to the credit side of the Profit and Loss account. Madison's administrative expenses of $145.73, and his selling expenses of $140.00 are transferred from the debit of their respective accounts to the debit of the Profit and Loss account. The Profit and Loss account now shows a balance of $150.16, which represents the net profit for the year; therefore, as explained above, it is transferred to the credit side of Madison's Capital account.

Illustration of Accounts After Closing Entries Are Made

After the above entries have been made, the Sales account, Selling Expenses account, Administrative Expenses account, Profit and Loss account, and Proprietor account of Madison will appear as follows:

Sales

192						192					
Dec.	31	Cost of Goods				Dec.	3			29	18
		Sold		1,125	85					38	76
		Gross Profit on								42	50
		Sales		435	89					79	46
							9			18	63
										17	50
										91	60
							13			27	92
							27			22	50
										36	86
										17	45
										64	56
										56	45
							31			1,018	37

Selling Expenses

192						192					
Dec.	8			25	00	Dec.	31	Profit & Loss		140	00
	16			25	00						
	23			25	00						
	29			30	00						
	31			35	00						

Administrative Expenses

192						192					
Dec.	1			100	00	Dec.	31	Profit & Loss		145	73
	31			36	73						
	31			9	00						

Profit and Loss

192						192					
Dec.	31	Selling Exp.		140	00	Dec.	31	Gross Profit			
	31	Admr. Expenses		145	73			on Sales		435	89
	31	Net Profit		150	16						

James Madison, Proprietor

						192					
						Dec.	1			1,940	00
							31	Net Profit		150	16

Closing an Account

In the discussion of the account in Chapter V it was explained that when the debits and the credits of an account are equal it is said to be in *balance.* When an account balances, it is indicated by what is known in accounting as Closing the Account. This is done (1) by placing the totals on their respective sides on the same line, and by drawing a single line above the totals to indicate the addition by which the totals are obtained, and (2) by drawing double lines under the totals, which in accounting indicates that all amounts above these lines are to be ignored in future accounting statements and reports. Illustrations of the method of closing accounts are given below.

After the closing entries are made at the end of the fiscal period the expense and income accounts will be in balance and should be ruled so as to indicate this fact. The accounts of James Madison, which are in balance, will, when ruled, appear as follows:

Purchases

192						192				
Dec.	2			240	00	Dec.	31	Inventory	1,450	00
	6			150	00		31	Cost of Goods		
	17			465	00			Sold	1,125	85
	20			360	85					
	24			360	00					
	31	Inventory		1,000	00					
				2,575	85				2,575	85

Sales

192						192				
Dec.	31	Cost of Goods				Dec.	3		29	18
		Sold		1,125	85				38	76
	31	Gross Profit							42	50
		on Sales		435	89				79	46
							9		18	63
									17	50
									91	60
							13		27	92
							27		22	50
									36	86
									17	45
									56	45
									64	56
							31		1,018	37
									1,561	74

Note: the debit total row above also shows 1,561 74 on the left side.

Selling Expenses

192						192					
Dec.	8			25	00	Dec.	31	Profit & Loss		140	00
	16			25	00						
	23			25	00						
	29			30	00						
	31			35	00						
				140	00					140	00

Administrative Expenses

192						192					
Dec.	1			100	00	Dec.	31	Profit & Loss		145	73
	1			36	73						
	31			9	00						
				145	73					145	73

Profit and Loss

192						192					
Dec.	31	Selling Expenses		140	00	Dec.	31	Gross Profit			
	31	Admr. Expenses		145	73			on Sales		435	89
	31	Net Profit		150	16						
				435	89					435	89

Balancing an Account

Sometimes it is desirable to show on the face of the account the difference between the total debits and credits. This is accomplished by writing the difference, which as previously explained is known as the balance, on the side showing the smaller total and then ruling the account and entering the totals which are now equal on each side. After the account has been thus ruled or balanced, the amount of the balance is brought down on the first line below the ruling on the larger side. The method of thus balancing an account may be illustrated by the Cash account at the top of page 126.

Cash

Date		Item	F	Amount	Date		Item	F	Amount
192					192				
Dec.	1			940.00	Dec.	1			100.00
	15			22.50					36.73
				36.86		6			150.00
	31			1,018.37		8			25.00
						16			25.00
						23			25.00
						24			360.00
						25			50.00
									300.00
						29			30.00
						31			35.00
									220.00
									400.00
									9.00
							Balance		252.00
				2,017.73					2,017.73
Jan.	1	Balance		252.00					

Closing the Proprietor's Capital and Personal Accounts

At the end of the fiscal period the Personal account of the proprietor should be transferred to his Capital account. In the case of James Madison, his Personal account shows a debit balance of $50.00, consequently his Capital account should be debited for $50.00 and his Personal account credited for $50.00. After this entry is made, these two accounts will appear as follows:

James Madison, Proprietor

Date		Item	F	Amount	Date		Item	F	Amount
192					192				
Dec.	31			50.00	Dec.	1			1,940.00
						31	Net Profit		150.16

James Madison, Personal

Date		Item	F	Amount	Date		Item	F	Amount
192					192				
Dec.	25			50.00	Dec.	31			50.00

The Personal account is now in balance and should be ruled accordingly. It will then appear as follows:

James Madison, Personal

Date		Item	F	Amount	Date		Item	F	Amount
192					192				
Dec.	25			50.00	Dec.	31			50.00

At the end of the fiscal period it is customary to balance and rule the Proprietor's account in the same manner as the Cash account

on page 126. The Proprietor account of James Madison when so ruled will be as follows:

James Madison, Proprietor

192						192					
Dec.	31			50	00	Dec.	1			1,940	00
	31	Net Worth		2,040	16		31	Net Profit		150	16
				2,090	16					2,090	16
						Jan.	1			2,040	16

Ruling of Personal and Note Accounts

With the exception of the Cash account, it is not customary, under ordinary circumstances, to balance asset and liability accounts as explained above. Usually no purpose is served in balancing them and if they are ruled in this manner it is more difficult to obtain historical information from them. In the case of the accounts with Notes Receivable and Payable and Accounts Receivable and Payable, to which there are frequent entries, it is undesirable to carry the totals along indefinitely and it is more undesirable to balance them in the manner illustrated by the above Cash account. Since the customer in making a payment usually pays an amount equal to one or more amounts which he owes, each credit to a customer's account usually corresponds to one or more debits to the same account. The same is true with reference to the Notes Receivable account, since usually one or more notes is paid in total at each payment. The same practice is followed by the business in paying its accounts payable and notes payable, so it will usually be found that the debits to these accounts offset corresponding credits. It has become customary, therefore, to cancel the debits and credits which offset each other by drawing a line on the debit and credit side at the point where all the debits above the line equal all the credits above the corresponding line on the opposite side. In finding the balance of the account in the future, only the items below these lines are considered. This reduces the mechanical work involved in finding the balance of such accounts.

The method of ruling such accounts may be indicated by the following illustration of a customer's account:

L. S. Lyon

192						192					
Dec.	3			22	50	Dec.	15			22	50
	9			18	63						
	27			29	18						

Transferring Accounts.

When a page in the ledger is full, it is necessary to transfer the account to another page. This may be done by balancing the account and transferring the balance only to the new page, or the totals of the debits and credits may be transferred. The latter is preferable, because it is of some value to know the total debits and credits which have been made in the account, and this is not shown by the first method. The rulings and explanations made when accounts are so transferred are shown in the following illustrations:

PAGE 6

Cash

1920						1920						
Jan.	1	Balance		3,000	00	Jan.	31			4,000	00
	31			4,000	00	Feb.	28			7,176	21
Feb.	28			8,131	75	Mar.	31			4,823	79
Mar.	31			6,868	25	Apr.	30			5,911	84
Apr.	30			5,431	49	May	31			6,088	16
May	31			7,568	51	June	30			5,001	71
June	30			4,321	76	July	31			4,998	29
July	31			5,678	24						
	31	For'd to page 10		45,000	00		31	For'd to page 10		38,000	00

PAGE 10

Cash

July	31	For'd from p. 6		45,000	00	July	31	For'd from p. 6		38,000	00

Summary

When the adjusting and closing entries, as explained above, have been made, the expense and income accounts will all be closed and only the asset, liability, and proprietorship accounts will remain open on the ledger. The asset accounts have been adjusted so as to show the present value of the property of the business and the net profit or loss for the fiscal period has been transferred to the Proprietorship account, so it now shows the proprietor's net worth as it remains at the end of the fiscal period. The ledger accounts are now ready to have recorded in them the transactions of the next fiscal period.

There are other methods than the one explained above by which the ledger summary might be made. The above method, however, is in harmony with good accounting practice and it is deemed advisable to use it in connection with elementary work, since it follows the summary shown on the Statement of Profit and Loss.

QUESTIONS FOR CLASS DISCUSSION

1

On December 31st, M. M. McGee has $1,000.00 worth of merchandise on hand which cost $1.00 a unit, but which he could now purchase at 90 cents a unit. The retail selling price of the articles is $1.10 each. At what amount should this merchandise appear on the Balance Sheet of McGee?

2

On the Statement of Profit and Loss of L. C. Marshall, the cost of goods sold is shown as follows:

COST OF GOODS SOLD		
Inventory January 1, 1920 . .	$2,000.00	
Purchases	6,000.00	
	$8,000.00	
Less: Inventory December 31, 1920	2,500.00	
Net Cost of Goods Sold .		$5,500.00

What entries would be required to show the above results in the ledger?

3

J. H. Hockaday has made sales to the amount of $6,000.00 during the month. The cost of goods sold is $4,500.00. How would the gross profit on sales be shown in the ledger of Hockaday?

4

The expenses of Hockaday for the month are as follows: selling expenses, $200.00; administrative expenses, $300.00. What would the net profit of Hockaday be and how would this be shown in his ledger?

5

What entries are necessary to close the Profit and Loss account of Hockaday?

6

The total of the debits to the Purchases account is $10,000.00, and the total of the credits to this account is the same. How is this equality of debits and credits shown?

7

The total of the debits to the Cash account is $8,000.00, and the total of the credits is $6,000.00. What is the cash balance? How may this be shown in the account?

8

Explain how a personal account may be ruled.

9

The total of the debits to the Cash account is $15,000.00, and the total of the credits is $9,000.00. The ledger page on which the Cash account appears is filled, and it is necessary to transfer this account to a new page. Explain how this may be done.

10

After the closing of the ledger is completed at the end of the fiscal period, what open accounts are left in the ledger?

LABORATORY MATERIAL

The purpose of the following exercises is to provide practice in making the adjusting and closing entries required at the close of the fiscal period as discussed in this chapter. These exercises are to be prepared on loose sheets of paper ruled according to the nature of the work. The Balance Sheets and the Statements of Profit and Loss required are to be prepared as previously instructed.

Exercise No. 51

The following is the Trial Balance of E. R. Taylor:

E. R. Taylor
Trial Balance, June 30, 1919

Cash	$ 1,000.00	
Notes Receivable	300.00	
Accounts Receivable	3,700.00	
Merchandise Inventory	2,100.00	
Furniture and Fixtures	400.00	
Delivery Equipment	500.00	
Notes Payable		$ 400.00
Accounts Payable		2,600.00
E. R. Taylor, Proprietor		6,000.00
Sales		20,000.00
Purchases	16,000.00	
Selling Expenses	2,000.00	
Administrative Expenses	3,000.00	
	$29,000.00	$29,000.00

Instructions: Taylor's inventory of June 30th is $4,000.00. Make a Balance Sheet and a Statement of Profit and Loss for Taylor as of the above date.

Exercise No. 52

On loose leaf ledger paper, open accounts to give effect to the Trial Balance of Taylor. Allow five lines for each account. Make the entries necessary to adjust and close Taylor's ledger.

Exercise No. 53

Make the entries necessary to adjust and close the ledger of N. W. Barnes as prepared in Exercise No. 45. The inventory of Barnes is given in Exercise No. 49.

Exercise No. 54

Make the entries necessary to adjust and close the ledger of D. D. Sells as prepared in Exercise No. 46. The inventory of Sells is given in Exercise No. 47.

Exercise No. 55

The following items are obtained from the records of A. C. Davis on December 31, 1919:

Cash	$ 500.00
Administrative Expenses	2,000.00
A. C. Davis, Prop.	5,000.00
Purchases	9,600.00
Notes Receivable	100.00
Furniture and Fixtures	400.00
Notes Payable	800.00
Selling Expenses	1,000.00
Sales	12,400.00
Accounts Receivable	3,200.00
Mdse. Inventory, Jan. 1, 1919	2,800.00
Accounts Payable	2,200.00
Delivery Equipment	800.00

The inventory of merchandise on December 31, 1919, is $3,800.00.

Instructions: 1. Arrange these items in proper order and prepare a Trial Balance.

2. Make a Balance Sheet and Statement of Profit and Loss.

3. Open accounts necessary to record the items shown on the Trial Balance, allowing five lines for each account.

4. Make the adjusting and closing entries and rule the accounts that balance.

CHAPTER X

THE SOURCE OF THE LEDGER ENTRIES

The Need for an Additional Record

It has been explained in the preceding chapters that it is the function of accounting to present to the owner by means of reports, usually made periodically, the information which he needs in the management of his business. The account has been discussed as the means by which the information which appears on these reports is obtained. It has also been explained how the transactions which the business performs may be analyzed and their effect on its financial condition recorded in the accounts. Although the transactions of the business might be recorded directly in the accounts at the time of their occurrence, it has been found by experience that such a practice is not advisable. There are several reasons why this is true.

In the first place, the information which can be recorded in the account is very meager. Since the account is a means by which information is summarized and classified, it does not give details, and yet there are certain details relating to transactions which it is desirable to record. Further, the debits and credits resulting from a transaction are recorded in different accounts and if an error is made in recording the amount of one of them, or if one of them is recorded in the wrong account or on the wrong side of an account, it is very difficult to find the error. An illustration or two will make this plain: if James Madison purchases $500.00 worth of merchandise from A. L. Anderson, on account, the Purchases account should be debited and A. L. Anderson credited for $500.00. If an error is made, however, and Anderson is credited for $50.00 instead of $500.00, when a Trial Balance is taken and it is found that the debits and credits are not equal, it will be very difficult to find the error. If James Madison sells merchandise valued at $200.00 to Henry James on account, the account with Henry James should be debited and Sales account credited with $200.00. If an error is made and the account with William James is debited instead of the account with Henry James, the former will object when a bill for payment is submitted to him, because he is charged with

merchandise which he did not purchase. From the information given in the account it will not only be impossible to judge the validity of his objection, but also difficult to determine to whom the charge should be made if not to him. It is also quite difficult and tedious to enter transactions one by one into the accounts as they take place, and in a business of considerable size this is almost impossible.

For these, as well as other reasons which it is unnecessary to enumerate, it is customary to record transactions chronologically at the time of their occurrence in certain records, frequently called Books of Original Entry. In these records certain desired information with reference to the transactions is given and the accounts which are to be debited and credited as a result of the transactions indicated. From time to time, the debits and credits indicated in the books of original entry are transferred to the ledger accounts, which in turn constitute the basis of the accounting reports.

The Nature of Books of Original Entry

The nature and form of the books of original entry, and particularly the nature of the information recorded in them, is determined largely by the nature of the information which it is desired that the accounts provide. In turn, the number and the nature of the accounts are determined by the type of information needed in the management of the business. For this reason the accounting reports and the accounts used as a basis for the reports have been discussed before attempting to explain the books of original entry, which are but means or devices used to collect and to substantiate, when necessary, the information recorded in the accounts. Various kinds of books of original entry may be used, depending upon the size and nature of the business. It will be the purpose of subsequent chapters to explain the construction and use of typical illustrations of the various kinds. It is the purpose of the present chapter to explain certain primary principles governing the use of such records and to illustrate the simplest type of the books of original entry.

The Journal

The simplest type among books of original entry is one in which all the transactions of the business are recorded in chronological order. This book, usually known as the Journal, contains a daily

record of current transactions. In accounting practice it is customary to use several journals, recording only one class of transactions in each, with the exception of one which serves as a sort of a general journal and in which are recorded all the transactions which can not be recorded in the special journals. These special journals are frequently called *records* or *books,* and are usually identified by the name of the transactions recorded in them; hence, there are cash books, sales books, purchases books, etc. Since the special journals are called by distinctive titles, the general journal, that is, the one containing miscellaneous transactions, is frequently termed the *journal,* without any descriptive title, and for brevity it will be so called here.

Although in practice it is not customary to record all transactions in one journal, it is thought best to use but the one book of original entry for purpose of illustration at this time. This not only tends to simplicity, but it also aids the student to understand all other books of original entry, since they are but modifications of the journal. In subsequent chapters, other books of original entry will be explained and illustrated.

Although the form of the journal varies somewhat, the standard form is ruled as follows:

Standard Form of Journal Page

	(1)	(2)	(3)	(4)	(5)

The use of the columns on the standard form of a journal page is as follows:

(a) Column (1) is the folio column, in which is inserted at the time of posting the page of the ledger to which the item appearing on that line is transferred.

(b) Column (2) is the account column, in which is written the names of the accounts which are to be debited and credited. The account to be debited is written first and the account to be credited is written on the line below it, a little to the right.

(c) Column (3) is the explanation column, in which is explained the nature of the transaction which gave rise to the debits

and credits to the accounts written in the account column. Frequently the explanation is not restricted to this column but is written under the names of the accounts in the account column and extends across both columns (2) and (3).

(d) Column (4) is the debit column, in which is written the amount which is to be debited to the account indicated in the account column.

(e) Column (5) is the credit column, in which is written the amount to be credited to the account indicated in the account column.

The date of the first transaction recorded in the journal is written at the top of the page above the ruling, the month, day, and year being given. The date of all other transactions performed during the same month is indicated by writing the day in the middle of the journal page on the line below the last transaction.

Illustration of the Journal

In order to illustrate the use of the journal as a book of original entry, a few simple transactions are given. It is not practical to give sufficient transactions to represent the complete operations of even a small business, but the following are representative of the kind of transactions which might be performed by a retail grocery store:

Jan. 1. G. B. Crawford invested $4,000.00 cash in the retail grocery business.
Paid rent for the month, $30.00.
2. Purchased office furniture and equipment for cash, $300.00.
3. Purchased stock of groceries for cash from G. B. Brown, $3,000.00.
4. Paid $25.00 city and state license for one year.
5. Purchased from the Chicago Wholesale Grocery Company, on account, merchandise, $600.00.
8. Sold, on account, A. B. Hill *merchandise, $10.50.

(*Concluded on page 140*)

* In practice, each clerk retains a list of the merchandise which he sells a customer. Since the customer will also require a list so that he may check the merchandise delivered, the clerk makes his list in duplicate by the use of carbon paper. The original copy accompanies the merchandise, and the carbon copy goes to the bookkeeper as evidence of the transaction.

January 1, 192

1	Cash	4000	
2	G. B. Crawford Proprietor		4000
	Invested in the retail grocery business.		
	1		
1	Administrative Expenses	30	
1	Cash		30
	Paid rent for the month.		
	2		
1	Furniture & Fixtures	300	
1	Cash		300
	Purchased office equipment for cash.		
	3		
3	Purchases	3000	
1	Cash		3000
	Bought stock of groceries for cash.		
	4		
3	Selling Expenses	25	
1	Cash		25
	Paid city and state license for 1 yr.		
	5		
3	Purchases	600	
2	Chicago Wholesale Grocery Co.		600
	Bought merchandise on account.		
	8		
1	A. B. Hill	10.50	
2	Sales		10.50
	Sold merchandise on account.		
	8		
1	B. A. Griswold	12	
2	Sales		12
	Sold merchandise on account.		

Illustration No. 7—Journal—*Continued*

January 8, 192

1	R. L. Greene	18	
2	Sales		18
	Sold merchandise on account.		
	11		
1	Cash	250 50	
2	Sales		250 50
	Received for sundry cash sales to date.		
	13		
3	Purchases	200	
2	Quaker Oats Co.		200
	Bought merchandise on account.		
	16		
1	A. B. Hill	13	
2	Sales		13
	Sold merchandise on account.		
	16		
1	A. M. Chapman	16	
2	Sales		16
	Sold merchandise on account.		
	16		
1	B. A. Griswold	20	
2	Sales		20
	Sold merchandise on account.		
	20		
3	Purchases	250	
2	Washburn Crosby Co.		250
	Bought merchandise on account.		
	22		
1	Cash	10 50	
1	A. B. Hill		10 50
	Received in full of account.		

Illustration No. 7—Journal—*Continued*

January 22, 192

1	Cash	12	
1	B. A. Griswold		12
	Received in full of account		
	25		
2	Chicago Wholesale Grocery Co.	600	
1	Cash		600
	Paid in full of account		
	27		
1	Cash	200	
2	Sales		200
	Received for sundry cash sales to date		
	31		
3	Administrative Expenses	12	
1	Cash		12
	Paid heat and light $6.00, telephone $5.00, water $1.00.		

Illustration No. 7—Journal—*Concluded*

Jan. 8. Sold the following customers on account:
- B. A. Griswold $12.00
- R. L. Greene 18.00

11. Received for sundry cash sales to date $250.50.
13. Purchased, on account, from the Quaker Oats Co., merchandise, $200.00.
16. Sold to the following customers, on account:
    - A. B. Hill $13.00
    - A. M. Chapman 16.00
    - B. A. Griswold 20.00
20. Purchased, on account, from the Washburn-Crosby Co., flour, $250.00.
22. Received from A. B. Hill $10.50, and from B. A. Griswold $12.00, each in full of bill of Jan. 8th.
25. Paid the Chicago Wholesale Grocery Company, in payment of goods purchased on January 5th, $600.00.
27. Received for sundry cash sales to date, $200.00.
31. Paid the following expenses for the month: heat and light, $6.00; telephone, $5.00; water, $1.00.

A record of the foregoing transactions is given in Illustration No. 7, pages 138-140.

Posting

The purpose of the books of original entry is to serve as a medium through which transactions are passed on their way to the ledger accounts. Consequently, it is necessary to transfer the debits and credits recorded in these books to the accounts to which they pertain. This process of transferring the debits and credits from the journal and other books of original entry to the accounts in the ledger is known as Posting. In the case of the journal, it consists in transferring the items in the debit column to the debit of the accounts indicated in the account column, and transferring the items in the credit column to the credit of the accounts likewise indicated. In order to avoid errors, it is customary first to post all debits to the debit side of the respective accounts and then to post all credits to the credit side of the respective accounts.

Although there is no stated time at which posting must be done, it is desirable that it be done at frequent intervals. In the case of personal accounts, especially customers' accounts, it is preferable that the posting be done daily so the status of the account can be determined at any time. The value of the daily posting of these accounts will be explained in detail in connection with the sales and purchases records.

Paging

When items are posted from a book of original entry to the ledger, the page of the ledger on which the account appears and to which the item is posted is placed in the folio column in the book of original entry. At the same time the page of the book of original entry from which the item is posted is placed in the folio column of the account. This process of indicating the page from which and to which an item is transferred is known in accounting as Paging.

Illustration of Posting

If the entries recorded in the journal given in Illustration No. 7 are posted to accounts, the results will be as in Illustration No. 8. If the student will trace each entry from the journal given in Illustration No. 7 to the ledger accounts illustrated, it will make quite clear to him how the process of posting is performed.

Cash

192 Jan	1		1	4000	192 Jan	1	1	30
	11		2	250 50		2	1	300
	22		2	10 50		3	1	3000
			3	12		4	1	25
	27	506.00	3	200		25	3	600
				4473 00		31	3	12
								3967

A. B. Hill

192 Jan	8	1	10 50	192 Jan 22	2	10 50
	16	2	13			

B. A. Griswold

192 Jan	8	1	12	192 Jan 22	3	12
	16	2	20			

R. L. Greene

192 Jan	8	2	18

A. M. Chapman

192 Jan	16	2	16

Furniture and Fixtures

192 Jan	2	1	300

Illustration No. 8—Ledger—*Continued*

Chicago Wholesale Grocery Co.

Date		Items	Fol.	Amount	Date		Items	Fol.	Amount
192 Jan	25		3	600	192 Jan	5		1	600

Quaker Oats Co.

Date		Items	Fol.	Amount	Date		Items	Fol.	Amount
					192 Jan	13		2	200

Washburn Crosby Co.

Date		Items	Fol.	Amount	Date		Items	Fol.	Amount
					192 Jan	20		2	250

G. B. Crawford Proprietor

Date		Items	Fol.	Amount	Date		Items	Fol.	Amount
					192 Jan	1		1	4000

Sales

Date		Items	Fol.	Amount	Date		Items	Fol.	Amount	
					192 Jan	8		1	10	50
								1	12	
								2	18	
						11		2	250	50
						16		2	13	
								2	16	
								2	20	
						27		3	200	
									540	00

Illustration No. 8—Ledger—*Continued*

Purchases

Date		Explanation	Folio	Amount
192- Jan.	3		1	3000
	5		1	600
	13		2	200
	29		2	250
				4050

Selling Expenses

Date		Explanation	Folio	Amount
192- Jan.	4		1	25

Administrative Expenses

Date		Explanation	Folio	Amount
192- Jan.	1		1	30
	31		3	12
				42

Illustration No. 8—Ledger—*Concluded*

Trial Balance of Crawford's Ledger

The Trial Balance of the ledger of G. B. Crawford is as follows:

Trial Balance, January 31, 192..

Cash	$ 506.00	
A. B. Hill	13.00	
B. A. Griswold	20.00	
R. L. Greene	18.00	
A. M. Chapman	16.00	
Furniture and Fixtures	300.00	
Quaker Oats Co.		$ 200.00
Washburn-Crosby Co.		250.00
G. B. Crawford, Prop.		4,000.00
Sales		540.00
Purchases	4,050.00	
Selling Expenses	25.00	
Administrative Expenses	42.00	
	$4,990.00	$4,990.00

Summary

The purpose of the foregoing discussion is to illustrate the *process* by which transactions are recorded in books of original entry and then transferred to the accounts from which the accounting reports are made. It is the intention of this chapter to illustrate *principles* rather than *practices*. Consequently, the journal has been used in order to illustrate the use of books of original entry and their relation to the accounts. Journalizing, in the broadest sense, is a mental process by which transactions are analyzed and the debits and credits to which they give rise determined. It is a process which must take place, therefore, before a transaction can be recorded intelligently in any record. The result of this analysis as reflected in the records is shown more graphically in the journal than in the other books of original entry usually employed, therefore it is used by way of illustration. The application of the principles developed in this chapter to other books of original entry is discussed and illustrated in the chapters immediately following.

QUESTIONS FOR CLASS DISCUSSION

1

William Long, who conducts a small retail store, has followed the practice of recording his transactions directly in his ledger accounts. He has been unable to obtain a Trial Balance for several months and is unable to locate the error. Several customers claim that the monthly statements which he has sent them are incorrect and it has been quite difficult for him to locate the reasons thereof. He requests you to explain how his records may be kept so as to decrease the number of such errors and to make their detection easier. What would you recommend to him and how would you illustrate to him the advantages of the method recommended?

2

Mr. Long upon your recommendation has decided to use a journal in which to record his transactions before they go to the ledger accounts. He has never used a journal and is unfamiliar with its ruling and the purpose of the various columns of the standard journal page. How would you explain the use of the standard journal page to him?

3

It is also necessary for you to explain to Mr. Long how he may transfer the items recorded in the journal to the ledger accounts. Show by means of illustrations how you would explain this to him.

4

How often would you suggest to Mr. Long that he post his journal?

5

Assuming that customers frequently ask for the amount they owe, what method may be followed so that their accounts will show the amount due at any time?

If a customer disputes the amount of some item shown in his account how can the explanation with reference to this item be easily found?

7

William Long, in posting his journal, posts both the debit and the credit of each transaction before he proceeds to the next trans-

action. He has difficulty in obtaining his Trial Balance and finds that the cause of this difficulty is that he occasionally posts debit items to the credit of accounts and credit items to the debit of accounts. What method would you suggest that he follow in order to eliminate such errors?

8

The bookkeeper of the X Company is unable to obtain his Trial Balance. You suggest that he total the debit and credit columns of each page of his journal. He finds that the total of the debit column and the total of the credit column on one page do not agree. What would you suggest to him?

9

Explain how the year, month, and day of the month of the transactions recorded in the journal are shown.

10

The following accounts appear in the ledger of James Brown:

Cash

Jan.	1			1,000.00	Jan.	2			200.00
	3			50.00		4			150.00
						4			100.00

Furniture and Fixtures

Jan.	4			150.00					

Administrative Expenses

Jan.	4	Rent		100.00					

James Brown, Proprietor

					Jan.	1			1,000.00

Sales

					Jan.	3			50.00

Purchases

Jan.	2			200.00					

Analyze the entries in these accounts and give the journal entries which would be necessary to record the transactions which they represent.

LABORATORY MATERIAL

The purpose of the following exercises is to give practice in recording transactions in the journal and in posting from the journal; also to give further practice in taking a Trial Balance and preparing the Balance Sheet and the Statement of Profit and Loss.

Exercise No. 56

The following represent certain transactions of J. B. Small during the month of January:

Jan. 1. J. B. Small invested $1,000.00 in the retail grocery business. Paid for one month's rent of store, $50.00.
2. Bought of E. W. Ryan, on account, merchandise, $76.50.
3. Bought of Evans Bros., on account, merchandise, $148.75.
4. Sold R. A. Miller, on account, coffee and flour, $15.40.
6. Paid for advertisement in a local paper, $5.00. (Debit selling expense.)
8. Paid William Randolph's salary as clerk for one week, $12.00.
10. Bought of A. H. James, for cash, merchandise, $196.00.
12. Received to date for sundry cash sales as shown by cash register, $91.25.
13. Paid E. W. Ryan $76.50, in full of account.
16. Sold the Congress Hotel, on account, merchandise, $57.80.
17. Sold L. T. Stanley, on account, merchandise, $18.60.
20. Received of R. A. Miller, in full of account, $15.40.
21. Bought of Rice Grocery Co., for cash, merchandise, $756.70.
23. Bought of Roads & Moss, on account, merchandise, $276.40.
24. Sundry cash sales to date as shown by cash register, $146.80.
26. Sold R. A. Miller, on account, merchandise, $49.70.
27. Received from the Congress Hotel, in full of account, $57.80.
30. Sundry cash sales to date, $68.70.
31. Paid William Randolph three weeks' salary as clerk, $36.00.

Instructions: 1. Enter the above transaction on a loose sheet of journal paper. Each entry requires the date, name of account debited, name of account credited, and a clear explanation of the transaction.

2. Open accounts on loose ledger paper, allowing ten lines for Cash, Sales, and Purchases accounts, and five lines for each of the other accounts, and post the entries from the journal.

3. Take a Trial Balance on a sheet of journal paper.

4. Prepare a Balance Sheet (inventory of merchandise Jan. 31st, $1,260.40) and a Statement of Profit and Loss.

5. Preserve this exercise for future use.

Exercise No. 57

The following represent certain transactions of William D. King during the month of February:

Feb. 1. William D. King invested $1,500.00 cash in the hardware business.
Paid one month's rent, $60.00.
2. Bought from Marsh & Marsh, on account, merchandise, $184.75.
3. Sold L. C. Dixon, on account, merchandise, $28.00.
5. Paid Gordon Long $272.36, for cash purchase of merchandise.
6. Bought from Pasket Hardware Co., on account, merchandise, $340.80.
Paid salary of clerk for one week, $25.00.
8. Paid Marsh & Marsh $100.00, on account.
9. Sold Walter James, on account, merchandise, $42.25.
10. Bought from Morrison Bros., on account, merchandise, $285.60.
Paid Marsh & Marsh, in full of account, $84.75.
12. Sold J. C. Wilson, on account, merchandise, $43.00.
Cash sales to date, $380.44.
15. Received $20.00 from Walter James, to apply on account.
16. Paid clerk for services, $25.00.
17. Bought from Jackson Bros., on account, merchandise, $311.85.
Sold General Construction Co., on account, merchandise, $261.00.
19. Paid Packet Hardware Co. $340.80, in full of account.
20. Paid Morrison Bros. $150.00, on account.
22. Cash sales to date, $197.25.
23. Sold Walter Best, on account, merchandise, $150.00.
24. Bought of Hibbard, Spencer, Bartlett & Co., for cash, merchandise, $820.40.

Feb. 24. Paid Morrison Bros. $100.00, to apply on account.
Paid $25.00, for advertising.
26. Received $22.25 from Walter James, in full of account.
27. Received for cash sales to date, $187.90.

Instructions: Journalize the above transactions, post (allow fifteen lines for the Cash account, ten lines for the Sales and Purchases accounts and five lines for each of the other accounts), take a Trial Balance, and prepare a Balance Sheet (inventory of merchandise Feb. 28th, $1,242.70) and a Statement of Profit and Loss as instructed at the close of Exercise No. 56.

Exercise No. 58

The following represent certain transactions of A. M. Chapman during the month of March:

Mar. 1. A. M. Chapman invested $3,000.00 cash in the retail coal business.
Paid rent for the month, $45.00.
per invoice of Mar. 1st, $275.00.
2. Bought from the Illinois Coal Co., on account, merchandise, $275.00.
Purchased, for cash, furniture and fixtures, $200.00.
3. Sold J. S. Miles, on account, merchandise, $32.50.
Bought from Darwin Coal Co., on account, merchandise, $225.50.
5. Paid $10.00, for telephone service for the month.
6. Bought from Black River Coal Co., on account, merchandise, $370.75.
7. Bought merchandise for cash, $1,500.00.
8. Paid Illinois Coal Co. $100.00, on account.
9. Sold Walter Johnson, on account, merchandise, $36.50.
10. Received for sundry cash sales, $161.05.
Sold Curry Hotel, on account, merchandise, $292.50.
12. Paid Illinois Coal Co. $175.00, in full of account.
13. Sold J. S. Miles, on account, merchandise, $19.50.
15. Cash sales to date, $125.00.
16. Received $22.00 from Walter Johnson, on account.
17. Paid clerk's salary for first half of month, $30.00.
19. Bought merchandise, for cash, $500.00.
20. Paid Black River Coal Co. $150.00, on account.

Mar. 21. Received from J. S. Miles, his 20-day note for $32.50, to apply on account.

22. Received $14.50 from Walter Johnson, in full, of balance due on bill sold on the 9th.

23. Sold Curry Hotel, on account, merchandise, $32.50.

24. Bought from Darwin Coal Co., on account, merchandise, $245.43.

Received for sundry cash sales, $141.65.

26. Sold A. B. Hill, on account, merchandise, $12.00.

27. Gave 30-day note for $225.00 to the Darwin Coal Co., to apply on account.

Received $200.00 from Curry Hotel, to apply on account.

29. Sold J. S. Miles, on account, merchandise, $48.00.

30. Received for sundry cash sales, $193.60.

31. Paid clerk hire $80.00.

Instructions: Journalize the above transactions, post (allow fifteen lines for the Cash and Sales accounts, ten lines for Purchases account, and five lines for each of the other accounts), take a Trial Balance, and prepare a Balance Sheet (inventory of merchandise Mar. 31st, $2,380.20) and a Statement of Profit and Loss as instructed at the close of Exercise No. 56.

Exercise No. 59

The following represent certain transactions of J. B. Sprague for the month of May:

May 1. J. B. Sprague invested $2,000.00 in the retail clothing business.

Bought of Smith Bros., on account. merchandise, $219.65.

Paid one month's rent, $60.00.

2. Bought of Cohen Bros. on account, merchandise, $78.53.

Sold C. D. Lawrence, on account, merchandise, $44.00.

4. Bought of Hart, Schaffner & Marx, for cash, merchandise, $225.50.

Bought of the Chicago Clothing Co., for cash, merchandise, $842.76.

5. Sold L. M. Hill, for cash, merchandise, $110.00.

Sold C. H. Taft, on account, merchandise, $62.50.

7. Paid Cohen Bros. $78.53, in full for bill purchased on the 2nd.

May 7. Sold Clarence Hart, on account, merchandise, $110.00.
9. Bought of Hart, Schaffner & Marx, on account, merchandise, $172.85.
10. Sold C. D. Lawrence, on account, merchandise, $88.50.
11. Received $60.00 from Clarence Hart, to apply on account.
12. Bought of Cohen Bros., on account, merchandise, $87.50.
14. Received $62.50 from C. H. Taft, in payment for bill sold him on the 6th.
15. Bought of Eisenberg & Settle, on account, merchandise, $208.23.
17. Bought of Smith Bros., on account, merchandise, $170.40.
18. Paid Eisenberg & Settle $208.23, in full for bill purchased on the 15th.
Sold C. H. Taft, on account, merchandise, $88.50.
19. Sold Clarence Hart, on account, merchandise, $21.25.
21. Received $30.00 from C. D. Lawrence, to apply on account.
Received cash from T. O. Bales for 2 suits of clothes, $90.00.
24. Paid Smith Bros. $100.00, to apply on account.
26. Received cash from Clarence Hart in full for bill sold on the 19th, $21.25.
30. Paid Hart, Schaffner & Marx $172.85, for bill bought on the 9th.
31. Paid bookkeeper's salary, $80.00; clerk's salary, $65.00.

Instructions: Journalize the above transactions, post (allow fifteen lines for the Cash, Sales, and Purchases accounts, and five lines for each of the other accounts), take a Trial Balance, and prepare a Balance Sheet (inventory of merchandise May 31st, $1,410.30) and a Statement of Profit and Loss as instructed at the close of Exercise No. 56.

Exercise No. 60

1. On loose journal paper record the transactions given in Exercise No. 45.

2. Open ledger accounts as instructed at the beginning of the exercise and post the journal entries.

3. Take a Trial Balance on a sheet of journal paper.

4. Compare the ledger accounts and the Trial Balance as obtained in this exercise with the ledger accounts and Trial Balance which you constructed when these same transactions were recorded directly in the ledger in Exercise No. 45.

CHAPTER XI

THE PURCHASES AND SALES RECORDS

Need for Additional Records

In the preceding chapter the nature and function of books of original entry and their relation to the ledger accounts have been discussed and the general journal has been given as an illustration of such records. Although all the transactions of a business may be recorded in the journal, it has been found by experience to be inexpedient to do so. There are some indications that in the development of accounting there was a time when the use of the journal as the only book of original entry was fairly prevalent. Such a use of the journal, however, has long been out of vogue in modern accounting practice. Various journals have been introduced, in each of which transactions of a certain nature are recorded, until now the general journal is used to record only those items which can not be recorded in any special journal. These special journals are used because in every business there are certain transactions of the same nature which are of frequent occurrence and if they are recorded in a separate journal, the work of recording them and also of transferring or posting them to the accounts is greatly reduced. Not only is the work of recording and posting reduced, but more information can be obtained from the records and this information obtained more readily. It is the purpose of the present and the following chapters to illustrate and explain the use of these additional journals.

The Recording of Purchases

In all mercantile businesses it is necessary to make frequent purchases of merchandise. If these purchases are recorded in the journal it is necessary in the case of each purchase to indicate that the Purchases account is to be debited and that some other account, usually a Creditor's account, is to be credited. To illustrate, assume that the following purchases have been made on account:

Jan.	1. William Cohagen	$300.00
	2. O. H. Robinson	400.00
	3. E. H. Wagner	500.00
	4. C. A. Ankromn	600.00

These items may be recorded in the journal, with explanations omitted, as follows:

January 1, 1920

		Purchases	300	00		
		William Cohagen			300	00
		2				
		Purchases	400	00		
		O. Robinson			400	00
		3				
		Purchases	500	00		
		E. H. Wagner			500	00
		4				
		Purchases	600	00		
		C. A. Ankromn			600	00

When these entries are posted, the ledger accounts affected will appear as follows:

Purchases

1920											
Jan.	1			300	00						
	2			400	00						
	3			500	00						
	4			600	00						

William Cohagen

						1920					
						Jan.	1			300	00

O. Robinson

						1920					
						Jan.	2			400	00

E. H. Wagner

						1920					
						Jan	3			500	00

C. A. Ankromn

						1920					
						Jan.	4			600	00

It will be noticed that by the above method the debit to the Purchases account must be indicated each time, and that when the journal is posted there will be four separate items debited to the Purchases account. If, however, the transactions with purchases are not recorded in the general journal where the other transactions are recorded, but on a separate page, the record of these four purchases may be somewhat as follows:

Merchandise Purchases

1920					
Jan.	1	William Cohagen		300.00	
	2	O. Robinson		400.00	
	3	E. H. Wagner		500.00	
	4	C. A. Ankromn		600.00	
		Total, Purchases Dr.			1,800.00

Since the page is headed "Merchandise Purchases," and nothing but purchases are recorded on the page, it is unnecessary to write "Purchases" in connection with each entry, or to write the amount of each purchase in the amount column, since the amount in each case is the same as the credit to the creditor. In posting to the accounts the total of all the items, or $1,800.00, may be carried to the debit of the Purchases account with the same result as given in the first illustration. The credits to the accounts of the creditors are made in the same manner as in the first illustration; hence, the equality of debits and credits is maintained, since there is one debit made to the Purchases account which is equal to the four credits posted to the Creditors' accounts. When these entries are posted, the ledger accounts affected will appear as follows:

Purchases

Jan.	4			1,800.00					

William Cohagen

					Jan.	1			300.00

O. Robinson

					Jan.	2			400.00

E. H. Wagner

					Jan.	3			500.00

C. A. Ankromn

					Jan.	4			600.00

The need and advantage of a separate journal for the recording of purchases should be apparent to the student from the above illustration since its use decreases about one-half both the work of recording and the work of posting. Of course, the more numerous the transactions with purchases the more advantageous will be the special journal. It should also be apparent that in the case of any transactions which are of frequent occurrence a similar advantage

will be obtained by recording them in a special journal. In a mercantile business the transactions which are of most frequent occurrence are those with merchandise purchased, with merchandise sold, with cash received, and with cash paid. Consequently these transactions are usually not recorded in the general journal as described and illustrated in Chapter X, but are recorded in special journals. It is the purpose of the present and the following chapters to discuss and illustrate the records necessary to record these transactions.

The Purchases Journal

As explained, the purpose of the purchases journal is to show the purchases made and the obligations incurred to creditors. The record of purchases is known by various names, being called "purchases book," "purchases register," "purchases record," "invoice book," etc. Whatever be the name, it is by its nature a journal, since it affords a record of transactions which give their effect on the ledger accounts; hence it may quite logically be called a purchases journal. The purchases journal is regarded in this discussion as a record of purchases of merchandise only. In some cases all purchases made by the business, whether of merchandise, fixed assets, or services, are recorded in the same journal. Such a record, however, is usually known by some other name, such as accounts payable register or voucher register. For the present the purchases journal will be considered in the restricted sense stated above.

There is some difference of opinion as to whether cash purchases should be recorded in the purchases journal or whether only purchases on account should be contained therein, and the cash purchases be recorded in the cash record discussed in the following chapter. Usually cash purchases are of rather infrequent occurrence and they can more conveniently be recorded in the cash record. There are some cases, however, where it is desirable to have all purchases recorded in the purchases journal, and these will be discussed in subsequent chapters, but for the present this journal may be regarded as a record of purchases on account only.

Form of the Purchases Journal

The form of the purchases journal will vary, depending upon the size and nature of the business and the amount of the information

which the owner desires with reference to his purchases. The information usually desired with reference to purchases can be obtained from the form shown in Illustration No. 9.

The following purchases of J. B. Hill, for the month of January, are shown recorded in the purchases journal in Illustration No. 9:

Jan. 2. Bought of Klein Bros., City, terms account, merchandise per invoice No. 1, dated Jan. 2nd, $105.30.

3. Bought of Atlas Mills, Boston, terms 3/10, n/30, merchandise per invoice No. 2, dated Jan. 3rd, $146.50.

Terms indicate 3% discount if paid within 10 days.

7. Bought of Frazier & Frazier, Chicago, terms account, merchandise per invoice No. 3, dated Jan. 7th, $220.46.

12. Bought of L. P. Gerald, New York, terms account, merchandise per invoice No. 4, dated Jan. 12th, $18.25.

14. Bought of Lawrenson Bros., City, terms 30 days, merchandise per invoice No. 5, dated Jan. 14th, $114.85.

16. Bought of Berry & Benson, Atlanta, terms 1/20, n/60, merchandise per invoice No. 6, dated Jan. 14, $225.50.

23. Bought of C. O. Larson, Detroit, terms 60 days, merchandise per invoice No. 7, dated Jan. 21st, $89.50.

25. Bought of Lauerman Bros., Pittsburgh, terms account, merchandise per invoice No. 8, dated Jan. 22nd. $195.00.

January, 192

Date Recorded	L.F.	Account Credited	Address	Date of Invoice and Terms	Inv. No.	Amount
2		Klein Bros	City	Jan. 2, account	1	105 30
3		Atlas Mills	Boston	Jan. 3, 3/10, n/30	2	146 50
7		Frazier & Frazier	Chicago	Jan. 7, acct.	3	220 46
12		L. P. Gerald	New York	Jan. 12, acct.	4	18 25
14		Lawrenson Bros.	City	Jan. 14, 30 days	5	114 85
16		Berry & Benson	Atlanta	Jan. 14, 1/20, n/60	6	225 50
23		C. O. Larson	Detroit	Jan. 21, 60 days	7	89 50
25		Lauerman Bros.	Pittsburgh	Jan. 22, acct	8	195 —
31		Purchases Dr.				1115 36

Illustration No. 9—Purchases Journal

The use of the columns given in Illustration No. 9 is in the main apparent. The purpose of the second column headed "L. F." is to show the pages of the ledger on which appear the accounts named in the "Account Credited" column. The column headed "Invoice No." gives the number of the invoice or bill received from the creditor. As will be explained fully in a subsequent chapter, when goods are purchased the purchaser receives from the seller a written statement showing, among other things, the kind, amount, and price of the goods purchased. It is from this statement that the information recorded in the purchases journal is obtained. These statements are numbered consecutively and after being recorded in the purchases journal are filed so as to be available for future reference, if desired. The number entered in the "Invoice No." column serves to identify the invoice with the entry to which it pertains in case future comparisons are desired. Such comparisons may be desired in case a creditor objects to the amount paid him, or to the terms upon which he is paid, the discount deducted, etc.

Posting from the Purchases Journal

The posting from the purchases journal consists in transferring the separate items shown in the "Amount" column to the credit of the accounts of the creditors indicated in the "Account Credited" column, and transferring the total purchases which is obtained by totalling the items in the "Amount" column, to the debit of the Purchases account. The posting to the Creditors' accounts should be done daily, if possible, so that the status of their accounts can be obtained at any time by reference to the ledger. Frequently this posting is made at the same time that the entry is made in the purchases journal. As previously explained, the entry is made in the purchases journal from the purchase invoice, and after the entry is made, the invoice is stamped as entered and then filed for future reference. The routine of this procedure will be explained more fully after the purchase invoice has been discussed. The total of purchases is posted to the Purchases account at the time of taking a Trial Balance, usually monthly. The method of ruling the purchases journal after it has been posted, is shown in Illustration No. 9.

The Recording of Sales

In all mercantile businesses many of the transactions, and often the majority of them, relate to sales of merchandise. If these sales

are recorded in the journal it is necessary in the case of each sale to indicate that the Sales account is to be credited and that some other account, usually a Customer's account, is to be debited. To illustrate, it may be assumed that the following sales have been made on account:

Jan.	1.	D. C. Brown	$250.00
	2.	H. C. Page	350.00
	3.	M. A. Allen	450.00
	4.	Harvey Chase	550.00

These items may be recorded in the journal, with explanations omitted, as follows:

January 1, 1920

		D. C. Brown	250	00		
		Sales			250	00
		2				
		H. C. Page	350	00		
		Sales			350	00
		3				
		M. A. Allen	450	00		
		Sales			450	00
		4				
		Harvey Chase	550	00		
		Sales			550	00

When these entries are posted to the ledger, the accounts affected will appear as follows:

D. C. Brown

Jan.	1			250	00							

H. C. Page

Jan.	2			350	00							

M. A. Allen

Jan.	3			450	00							

Harvey Chase

Jan.	4			550	00							

Sales

						Jan.	1				250	00
							2				350	00
							3				450	00
							4				550	00

It will be noticed that by the foregoing method, the credit to the Sales account must be indicated each time, and that when the journal is posted there will be four separate items credited to the Sales account. If, however, the transactions with sales are not recorded with other transactions in the general journal, but on a separate page, the record of these four sales may be somewhat as follows:

Merchandise Sales

1920				
Jan.	1	D. C. Brown	250.00	
	2	H. C. Page	350.00	
	3	M. A. Allen	450.00	
	4	Harvey Chase	550.00	
		Total, Sales Cr.		1,600.00

Since the page is headed "Merchandise Sales," and nothing but sales are recorded on the page, it is unnecessary to write "Sales" in connection with each entry, or to write the amount of each sale in the amount column, since the amount in each case is the same as the debit to the customer. In posting to the accounts the total of all the items, $1,600.00, may be carried to the credit of the Sales account with the same result as given in the first illustration. The debits to the accounts of the customers are made the same as in the first illustration, hence the equality of debits and credits is maintained in the ledger, since there is one credit made to the Sales account which is equal to the four debits posted to the Customers' accounts. After these items are posted, the ledger accounts affected will appear as follows:

D. C. Brown

Jan.	1			250.00					

H. C. Page

Jan.	2			350.00					

M. A. Allen

Jan.	3			450.00					

Harvey Chase

Jan.	4			550.00					

Sales

					Jan.	4			1,600.00

The need and advantage of a separate journal for the recording of sales should be apparent to the student from the above illustration, since its use decreases about one-half both the work of recording and the work of posting. Of course, the more numerous the transactions with sales the more advantageous will be the special journal.

The Sales Journal

The purpose of the sales journal is to provide a record of the transactions with sales. In some businesses all sales of merchandise are recorded in the journal, while in others only sales on account are so recorded. Usually in a wholesale business all sales are recorded in the sales journal, while in a retail business only sales on account are recorded in the sales journal, the cash sales being entered in the cash record. One reason for this is that in a wholesale business few cash sales are made and these are of fairly large amount, hence it is not difficult to record them in the sales journal the same as sales on account, which of course results in a debit to the Customer's account and a credit to the Sales account. The cash received from the customer is debited to the Cash account and credited to the customer, thus canceling the amount debited to his account from the sales journal. This method will be more apparent if it is assumed that the Smith Retail Grocery Company, on January 1st, made a cash purchase of $500.00 from the Chicago Wholesale Grocery Company. The entries in journal form on the latter's book would be as follows:

Smith Retail Grocery Company . .	$500.00	
Sales		$500.00
Cash	500.00	
Smith Retail Grocery Company		500.00

When posted, the effect on the accounts will be as follows:

Cash

1920 Jan.	1			500	00						

Smith Retail Grocery Company

1920 Jan.	1			500	00	1920 Jan.	1			500	00

Sales

						1920 Jan.	1			500	00

It will be seen readily that the result is the same as if one entry had been made debiting Cash and crediting Sales; but in a large business, such as a wholesale house, the sales are frequently recorded by one person and the cash received by another, or even if recorded by the same person these items are recorded at different times and independently of each other, hence it is more convenient to make the two entries than to offset the one against the other. For purposes of illustration the entries are shown in journal form. Their effect on the accounts, however, is just the same when they are recorded in the sales and cash records.

In a retail business cash sales are frequent and usually many of them are for small amounts, hence it would be quite tedious and serve no useful purpose to make the two entries mentioned above or in fact to even make a separate entry for each sale. Consequently, it is customary to total the cash sales for the day and make one entry debiting Cash and crediting Sales. This entry is made in the cash record explained in the following chapter.

The sales record, like the purchases record, is known by various names, being called "sales record," "sales register," "sales journal," "sales book," etc. It is by its nature a journal, since it affords a record of transactions which give their effect on the ledger accounts, hence it may quite logically be called a sales journal.

Form of the Sales Journal

The sales journal varies in form even more than the purchases journal, because the information desired with reference to sales is more varied. In most retail stores, however, the information desired can be obtained from the form given in Illustration No. 10.

The following sales of R. A. Scott, for the month of February, are shown recorded in the sales journal in Illustration No. 10:

Feb. 3. Sold S. S. Marks, 503 Aurora St., City, terms account, merchandise per order No. 1, $49.00.

8. Sold A. Salee, Bessemer, terms 30 days, merchandise per order No. 2, $6.00.

12. Sold L. M. Mason, Wakefield, terms 2/10, n/30, merchandise per order No. 3, $7.00.

14. Sold G. L. Ramsey, 818 Cary St., City, terms 60 days, merchandise per order No. 4, $80.00.

18. Sold T. H. Thomas, 218 Norris St., City, terms account, merchandise per order No. 5, $5.50.

Feb. 20. Sold Davis & Fehr, 222 Main St., City, terms 1/30, n/60, merchandise per order No. 6, $5.00.

23. Sold John T. Larson, Watersmeet, terms 20 days, merchandise per order No. 7, $16.00.

27. Sold J. C. Watson, 365 Ayer St., City, terms account, merchandise per order No. 8, $10.00.

28. Sold Joe Tolan, 291 Ashland Ave., City, terms account, merchandise per order No. 9, $40.00.

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Date	L.F.	Account Debited	Address	Terms	Sale No.	Amount	
3		S. S. Marks	503 Aurora St. City	account	1	49	
8		A. Salee	Bessemer	30 days	2	6	
12		L. M. Mason	Wakefield	2/10, n/30	3	7	
14		G. L. Ramsey	818 Cary St., City	60 days	4	80	
18		T. H. Thomas	218 Norris St., City	account	5	5	50
20		Davis & Fehr	222 Main St., City	1/30, n/60	6	5	
23		John T. Larson	Watersmeet	20 days	7	16	
27		J. C. Watson	365 Ayer St., City	account	8	10	
28		Joe Tolan	291 Ashland Ave. City	account	9	40	
		Sales Cr.				218	50

Illustration No. 10—Sales Journal

Taking into consideration the explanations given with reference to the general journal and the purchases journal, the use of the columns in the above form should be self-evident.

Sometimes the individual items of goods sold, as well as the price of the same, are copied in the sales journal. This requires much additional work and serves no particular purpose. When goods are sold, the seller makes out a statement giving the quantity of each item, the price of the same, the total of each item, and the value of all items. This statement, which is usually called a bill or invoice, is made in duplicate; one copy is retained by the seller and from this copy the entry in the sales journal is made. It is numbered and filed so it can be easily obtained if desired. If it is necessary at any time to know the details given on the invoice they can be obtained readily from the filed copy of the bill, hence it is unnecessary to record these details in the sales journal.

Posting from the Sales Journal

The posting from the sales journal consists (1) in transferring the separate items shown in the "Amount" column to the debit of the accounts of the customers indicated in the "Account Debited" column and (2) transferring the total sales which is obtained by totalling the items in the "Amount" column to the credit of the Sales account. The debits to the accounts of the customers should be made daily, if possible, so that the status of their accounts can be obtained at any time. In the case of a wholesale business where customers from time to time are purchasing large bills on account this is especially important. Whether or not the one responsible for granting credit to customers will permit a further granting of credit will depend to a considerable degree upon the amount now owed by the customer and the promptness of past payments. He will expect to obtain this information from the accounts, but if all the charges to the customer have not been posted he may be deceived by what the account shows. The total of the sales is posted to the Sales account at the time the Trial Balance is made, usually monthly. The method of ruling the sales journal after it has been posted is shown in Illustration No. 10.

QUESTIONS FOR CLASS DISCUSSION

1

The Yorktown Creamery Company buys its milk and cream from different farmers. The farmers send their milk and cream to the company daily, but do not collect for it until the end of the month. It is necessary, therefore, for the company to make daily credits to the individual accounts of the farmers. At present they record all transactions in a general journal. As a consequence, numerous entries, such as the following, are made in the journal each day:

Purchases	$3.25	
James Johnson		$3.25
Purchases	4.00	
Fred Anderson		4.00
Purchases	3.75	
John Long		3.75

The manager of the Yorktown Creamery Company asks you to devise a method which will eliminate the necessity of making a debit to purchases each time milk or cream is purchased, which in turn calls for as many postings to the Purchases account. Explain the method which you would recommend.

2

About how much does the method you recommend to the Yorktown Creamery Company reduce the labor involved in recording its purchases and in posting?

3

The bookkeeper of the Yorktown Creamery Company can not see how the equality of debits and credits is maintained when the purchases journal is used. How would you explain and illustrate this?

4

The Yorktown Creamery Company purchases a typewriter for office use. Should this purchase be recorded in its purchases journal?

5

The Scott & Howe Lumber Company has a purchases register; the Twin City Bottling Works has a purchases record; the Warren Clothing Company has a purchases book; and the Ames Wholesale Company has a purchases journal. Explain.

6

How are cash purchases recorded?

7

The bookkeeper of the Brown Company has an entry in his purchases journal which he thinks is incorrect. How can he find the copy of the invoice from which he made the entry?

8

Explain how the purchases journal is posted.

9

Explain the advantages of the sales journal as a means of recording sales.

10

What is the essential information to be recorded in the sales journal?

11

The Chicago Wholesale Company sells $500.00 worth of merchandise for cash to the St. Louis Retail Dry Goods Company. Explain how this transaction would be recorded.

12

The St. Louis Retail Dry Goods Company sells $25.00 worth of merchandise for cash to Henry Jackson. Explain how this transaction would be recorded. Why is this transaction recorded differently from the transaction given in Question No. 11?

13

By what different names may the record of sales be known?

14

E. C. Williams comes into the clothing store of Ralph O'Connor and asks the amount of his indebtedness. O'Connor looks at Williams' ledger account and tells him he owes $16.00. Williams pays the amount and leaves. At the end of the month when O'Connor posts his books he finds that Williams owes him $4.00, which did not show in his account at the time he made the above payment. What should O'Connor do to avoid such errors as the above?

15

Explain how the sales journal is posted.

LABORATORY MATERIAL

The purpose of the following exercises is to give practice in recording transactions in the purchases and sales journals; in posting from these books, and in taking a Trial Balance:

Exercise No. 61

The following are the purchases of H. A. Cosgrove for the month of February:

Feb. 1. Bought of L. S. Lyon & Co., 46 Broad St., City, terms 2/10, n/30, merchandise per invoice No. 15, dated Feb. 1st, $300.00.

6. Bought of A. M. Chapman, 300 Locust St., St. Louis, terms 1/10, n/20, merchandise per invoice No. 16, dated Feb. 4th, $350.00.

10. Bought of E. R. Taylor, Detroit, terms 30 days, merchandise per invoice No. 17, dated Feb. 8th, $890.00.

20. Bought of O. T. Gooch & Co., Middletown, terms account, merchandise per invoice No. 18, dated Feb. 19th, $287.00.

25. Bought of Pipken Bros., Little Rock, terms 60 days, merchandise per invoice No. 19, dated Feb. 23rd, $380.00.

28. Bought of Levy & Mayer, Kansas City, terms 1/10, n/20, merchandise per invoice No. 20, dated Feb. 26th, $430.50.

Instructions: 1. Rule a sheet of paper similar to Illustration No. 9 and make the entries for the above transactions.

2. Post these entries, using a loose sheet of ledger paper; allow five lines for each account.

3. Take a Trial Balance.

Exercise No. 62

The following are the purchases of A. J. Sturges for the month of March:

Mar. 2. Bought of Wolverine Shoe Co., Milwaukee, terms account, merchandise per invoice No. 12, dated Feb. 27th, $490.25.

3. Bought of Bradley & Metcalf, Chicago, terms 10 days, merchandise per invoice No. 13, dated Mar. 2nd, $381.50.

Mar. 4. Bought of M. S. Hall, St. Louis, terms 30 days, merchandise per invoice No. 14, dated Mar. 3rd, $165.37.

18. Bought of Wolverine Shoe Co., terms account, merchandise per invoice No. 15, dated Mar. 15th, $98.63.

25. Bought of Bradley & Metcalf, terms 30 days, merchandise per invoice No. 16, dated Mar. 20th, $128.90.

26. Bought of Evans Shoe Co., Boston, terms 1/10, n/30, merchandise per invoice No. 17, dated Mar. 20th, $78.50.

31. Bought of O. L. Harlan, New York, terms 2/30, n/60, merchandise per invoice No. 18, dated Mar. 21st, $127.35.

Bought of M. S. Hall, terms on account, merchandise per invoice No. 19, dated Mar. 22nd, $135.20.

Instructions: Follow instructions given at the close of Exercise No. 61.

Exercise No. 63

The following are the sales of A. B. Clarke for the month of January:

Jan. 1. Sold B. G. Moulton, 5644 Kenwood St., City, terms account, merchandise per order No. 1, $18.40.

3. Sold R. M. Askin, 1642 Missouri St., City, terms account, merchandise per order No. 2, $14.60.

6. Sold A. R. Miller, 1840 Jefferson St., City, terms 30 days, merchandise per order No. 3, $13.80.

9. Sold Robt. A. Grant, 1648 Russell St., City, terms 60 days, merchandise per order No. 4, $9.20.

18. Sold M. Hinssen, 1719 Chase Ave., City, terms 1/10, n/30, merchandise per order No. 5, $4.80.

24. Sold O. L. Laws, 4268 Kimbark Ave., City, terms account, merchandise per order No. 6, $3.40.

30. Sold A. Law, 1460 University Ave., City, terms 2/30, n/60, merchandise per order No. 7, $3.60.

Instructions: 1. Rule a sheet of paper similar to Illustration No. 10 and make the entries for the above transactions.

2. Post these entries, using a loose sheet of ledger paper; allow five lines for each account.

3. Take a Trial Balance.

Exercise No. 64

The following are the sales of A. J. Sturges for the month of March:

Mar. 1. Sold J. C. Williams, 215 North St., City, terms account, merchandise per order No. 17, $11.00.

4. Sold A. B. Clifford, Saxon, terms 30 days, merchandise per order No. 18, $5.25.

9. Sold B. L. Dobell & Co., Knoxville, terms 20 days, merchandise per order No. 19, $23.00.

12. Sold L. A. Ring, Watertown, terms 2/10, n/30, merchandise per order No. 20, $4.00.

15. Sold L. W. Pierce, Saxon, terms 30 days, merchandise per order No. 21, $10.00.

18. Sold K. C. Best, 105 Main St., City, terms 10 days, merchandise per order No. 22, $9.00.

21. Sold J. D. Maxwell, 1121 Delta Ave., City, terms account, merchandise per order No. 23, $8.00.

26. Sold A. C. Sheep, Clinton, terms 30 days, merchandise per order No. 24, $6.00.

Instructions: Follow instructions given under Exercise No. 63.

Exercise No. 65

The following are the sales and purchases made on account by C. A. Arnold during the month of May:

May 2. Bought of Moore & Moore, City, terms 10 days, merchandise per invoice No. 1, dated April 28th, $496.81.

3. Bought of Pickering Hardware Co., Cincinnati, terms 10 days, merchandise per invoice No. 2, dated May 2d, $387.65.

Sold E. M. Miller, 507 Gay St., City, terms account, merchandise per order No. 1, $7.50.

4. Bought of Johnson Bros., St. Louis, terms 30 days, merchandise per invoice No. 3, dated May 3d, $91.42.

Sold William A. Wallace, Evanston, terms 30 days, merchandise per order No. 2, $5:25.

6. Bought of Cline Hardware Co., Detroit, terms 30 days, merchandise per invoice No. 4, dated May 4th, $168.42.

May 9. Sold J. C. Wilson & Co., Hamilton, terms 30 days, merchandise per order No. 3, $33.10.

12. Sold G. L. Frye, 29 Main St., City, terms account, merchandise per order No. 4, $2.50.

15. Sold Henry Mason, Pittsburgh, terms account, merchandise per order No. 5, $9.15.

18. Bought of Evans Bros., Philadelphia, terms 30 days, merchandise per invoice No. 5, dated May 15th, $987.35.

Sold D. T. Sinton, Uniontown, terms 20 days, merchandise per order No. 6, $8.45.

21. Sold D. P. Lewis, 310 Chestnut St., City, terms account, merchandise per order No. 7, $5.00.

25. Bought of Belknap Hardware Co., Albany, terms 30 days, merchandise per invoice No. 6, dated May 20th, $462.85.

26. Sold G. L. Frye, terms account, merchandise per order No. 8, $6.00.

Bought of Cline Hardware Co., terms 30 days, merchandise per invoice No. 7, dated May 24th, $785.00.

30. Sold D. P. Lewis, terms account, merchandise per order No. 9, $6.90.

31. Bought of Pickering Hardware Co., terms account, merchandise per invoice No. 8, dated May 21st, $432.50.

Bought of Johnson Bros., terms 30 days, merchandise per invoice No. 9, dated May 22d, $356.00.

Instructions: Enter the above transactions in the purchases and sales journals, post from each book (allow eight lines for Cash, Sales, and Purchases accounts, and five lines for each of the other accounts), and take a Trial Balance.

Preserve this exercise for future use.

CHAPTER XII

THE CASH RECORD

The Recording cf Cash Receipts

In every business of any considerable size there are frequent transactions with cash receipts. If these transactions are recorded in the journal, it is necessary in the case of each transaction to indicate that the Cash account is to be debited and that some other account indicating the source of the cash is to be credited. To illustrate, assume that the following transactions with cash receipts have been performed:

Jan. 1. Received from J. P. Adams $280.00, to apply on account.
2. Received from H. L. King $340.00, in payment of his 30-day note.
3. Received from A. L. Elliott $160.00, to apply on account.
4. Received from a cash sale, $476.00.

Omitting the explanations, these transactions may be recorded in the journal as follows:

January 1, 1920

		Cash	280	00		
		J. P. Adams			280	00
		2				
		Cash	340	00		
		Notes Receivable			340	00
		3				
		Cash	160	00		
		A. L. Elliott			160	00
		4				
		Cash	476	00		
		Sales			476	00

When these entries are posted, the ledger accounts affected will appear as follows:

Cash

1920												
Jan.	1			280	00							
	2			340	00							
	3			160	00							
	4			476	00							

J. P. Adams

						1920						
						Jan.	1				280	00

Notes Receivable

						1920 Jan.	2			340	00

A. L. Elliott

						1920 Jan.	3			160	00

Sales

						1920 Jan.	4			476	00

It will be noticed that when these transactions are recorded in the journal the debit to the Cash account must be indicated each time, and that when the journal is posted, there are four separate items debited to the Cash account. If, however, the transactions with cash receipts are not recorded with the other transactions in the general journal, but on a separate page, the record of these four transactions may be as follows:

Cash Receipts

1920 Jan.	1		J. P. Adams	280	00		
	2		Notes Receivable	340	00		
	3		A. L. Elliott	160	00		
	4		Sales	476	00		
			Cash, Dr.			1,256	00

Since the page is headed "Cash Receipts," and nothing but cash receipts are recorded on the page, it is unnecessary to write "Cash" in connection with each entry, or to write the amount of the cash received in the amount column, since the amount received in each case is the same as the credit to the other account affected by the transaction. In posting to the accounts the total of all the items, $1,256.00, is carried to the debit of the Cash account with the same result as when the four separate items are posted from the journal as given in the first illustration. The credits to the accounts affected are made the same as when posted from the journal, hence the equality of debits and credits is maintained in the ledger, since there is one debit to the Cash account which is equal to the four credits made to the separate accounts.

After these entries are posted, the accounts affected are as follows:

Cash

1920 Jan.	4			1,256	00						

J. P. Adams

						1920 Jan.	1			280	00

Notes Receivable

						1920 Jan.	2			240	00

A. L. Elliott

						1920 Jan.	3			160	00

Sales

						1920 Jan.	4			476	00

The Cash Receipts Journal

The need and advantage of a separate journal for the recording of cash receipts should be apparent from the above illustration, since it reduces about one-half both the work of recording and the work of posting. The purpose of the cash receipts journal is to provide a record of all cash received. Cash received from all sources, regardless of its form, is recorded in this journal. Usually a separate entry is made for each transaction involving the receipt of cash. In some cases, however, where on the same date there are several transactions of the same kind, as the cash sales of a mercantile store, these transactions may be combined and one entry made for the total.

Form of the Cash Receipts Journal

The form of the cash receipts journal, like the form of all the other books of original entry, varies considerably, depending upon the nature and number of the transactions which are to be recorded in it. A simple form suitable for a small mercantile store may be ruled as in the illustration below:

Cash Receipts

Date	L.F.	Account Credited	Explanation	Amount		Total Cash Debited	
1920							
Jan. 1		H. L. Cogahen	Investment	5,000	00		
2		A. B. Hill	In Full of Account	80	00		
10		Notes Receivable	J. B. King, note 12/10	110	00		
15		E. C. Cline	On Account	90	00		
22		Sales	Cash Sales	300	00		
28		J. B. King	On Account	70	00		
30		Sales	Cash Sales	140	00		
		Cash, Dr.				5,790	00

Illustration of Cash Receipts Journal

Posting from the Cash Receipts Journal

The posting from the cash receipts journal consists in transferring the separate items shown in the "Amount" column to the credit of the accounts indicated in the "Account Credited" column, and transferring the total cash received which is obtained by totalling the items in the "Amount" column to the debit of the Cash account.

Each amount entered in the "Amount" column is posted to the credit side of the account written on the same line with it, this posting being done daily. At the end of the month, or when a Trial Balance is to be taken, the total of cash receipts is posted to the debit side of the Cash account in one amount.

The Recording of Cash Payments

In every business of any considerable size there are frequent transactions with cash disbursements. If these transactions are recorded in the journal, it is necessary in the case of each transaction to indicate that the Cash account is credited and some other account debited. To illustrate, assume that the following transactions with cash disbursements have been performed:

Jan. 1. Paid G. B. Monroe $176.00, to apply on account.
2. Paid rent for the month, $80.00.
3. Paid salary of clerk for one week, $30.00.
4. Paid R. E. Riley $290.00, in payment of 30-day note due on this date.

Omitting the explanations, these transactions may be recorded in the journal as follows:

January 1, 1920

		G. B. Monroe	176.00	
		Cash		176.00
		2		
		Administrative Expenses	80.00	
		Cash		80.00
		3		
		Selling Expenses	30.00	
		Cash		30.00
		4		
		Notes Payable	290.00	
		Cash		290.00

When these entries are posted, the ledger accounts affected will appear as follows:

G. B. Monroe

1920									
Jan.	1			176.00					

Administrative Expenses

1920 Jan.	2			80 00					

Selling Expenses

1920 Jan.	3			30 00					

Notes Payable

1920 Jan.	4			290 00					

Cash

					1920 Jan.	1			176 00
						2			80 00
						3			30 00
						4			290 00

It will be noticed that when these transactions are recorded in the journal the credit to the Cash account must be indicated each time, and that when the journal is posted there are four separate items credited to the Cash account. If, however, the transactions with cash disbursements are not recorded with the other transactions in the general journal, but on a separate page, the record of these four transactions may be as follows:

Cash Disbursements

1920 Jan	1	G. B. Monroe	176 00	
	2	Administrative Expenses	80 00	
	3	Selling Expenses	30 00	
	4	Notes Payable	290 00	
		Cash, Cr.		576 00

Since the page is headed "Cash Disbursements," and nothing but cash payments are recorded on the page, it is not necessary to write "Cash" in connection with each entry, or to write the amount of the cash paid in the amount column, since the amount in each case is the same as the debit to the other account affected by the transaction. In posting to the accounts the total of all the items, $576.00, is transferred to the credit of the Cash account with the same result as when the four separate items are posted from the journal as in the first illustration. The debits to the accounts affected are made the same as when posted from the

journal, hence the equality of debits and credits is maintained in the ledger, since there is one credit to the Cash account which is equal to the four debits made to the separate accounts.

After these entries are posted, the accounts affected are as follows:

G. B. Monroe

1920 Jan.	1			176	00						

Administrative Expenses

1920 Jan.	2			80	00						

Selling Expenses

1920 Jan.	3			30	00						

Notes Payable

1920 Jan.	4			290	00						

Cash

						1920 Jan.	4			576	00

The Cash Disbursements Journal

The need and advantage of a separate journal for the recording of cash payments should be apparent to the student from the above illustration, since its use decreases about one-half both the work of recording and the work of posting.

The purpose of the cash disbursements journal is to provide a record of cash paid. All cash payments, regardless of the form in which made, are recorded in this journal. Usually a separate entry is made for each transaction involving the payment of cash. In some cases, however, where frequent payments are made for the same purpose on the same date, they may be entered as a total. For instance, in a mercantile store where frequent cash purchases of produce are made on the same day, these payments may be entered in total.

Form of the Cash Disbursements Journal

The form of the cash disbursements journal, like the form of all the other books of original entry, varies considerably, depending upon the nature and number of the transactions which are to be

recorded in it. A simple form suitable for a small mercantile store may be ruled as in the illustration below.

Cash Disbursements

Date		L.F.	Account Debited	Explanation	Amount		Total Cash Credited	
1920								
Jan.	1		Selling Expenses	City License	50	00		
	3		Delivery Equip.	Auto Truck	1,000	00		
	3		Furniture and Fix.	Type., Desk and Chair	200	00		
	8		Administrative Ex.	Office Salaries	100	00		
	12		Selling Expenses	Ad in Local Paper	20	00		
	18		Purchases	J. M. Gray, for Cash	400	00		
	24		Administrative Ex.	Office Salaries	100	00		
	26		E. H. White	Invoice 12/25	250	00		
	30		O. P. King	Invoice 1/10	480	00		
	31		Selling Expenses	Delivery Expenses	50	00		
	31		Cash Cr.				2,650	00

Illustration of Cash Disbursements Journal

Posting from the Cash Disbursements Journal

The posting from the cash disbursements journal consists in transferring the separate items shown in the "Amount" column to the debit of the accounts indicated in the "Account Debited" column, and transferring the total cash paid, which is obtained by totalling the items in the "Amount" column, to the credit of the Cash account. The debits to creditors' accounts are usually posted daily so that the status of their accounts can be determined at any time. The remaining debits and the credit to the Cash account for the total cash payments are posted at the time the Trial Balance is made, usually monthly

The Cash Book

As explained in the foregoing discussion, the transactions with cash are of two kinds: those involving the receipt of cash, and those involving the payment of cash. Consequently, the two journals discussed in the preceding part of this chapter are used in connection with cash, one of which records the cash receipts and the other the cash disbursements. Frequently these journals are not kept as separate records, but are bound together and called the "cash book." In this case, a page recording cash receipts is immediately followed by a page recording cash payments, these pages alternating throughout the book. The cash receipts are recorded on the left-hand page of the cash book, and the cash payments are recorded

on the right-hand page; the former is termed the debit side of the cash book, and the latter the credit side.

The purpose of the cash book, as indicated above, is to record all cash received and all cash paid. Every transaction which involves a receipt of cash is recorded on the debit side of the cash book, and every transaction which involves the payment of cash is recorded on the credit side. It can be readily seen, therefore, that the difference between the totals of the two sides at any time should equal the cash on hand.

Form of the Cash Book

The form of the cash book need not be different from the form of the separate journals with cash receipts and cash disbursements, since it is but a combination of these two journals. When the two journals are combined in the cash book, it is customary to indicate the amount of cash on hand by *balancing* the cash book in the same manner that the Cash account is balanced. The method of doing this is indicated in Illustrations Nos. 11 and 12.

The following cash transactions of H. L. Cowan, for the month of January, are shown recorded in the cash book in Illustrations Nos. 11 and 12:

Jan. 1. H. L. Cowan invested $5,000.00 in the retail clothing business.
2. Paid city and state license, $50.00.
3. Purchased office equipment consisting of typewriter, desk, and 3 chairs, $200.00.
6. Received $80.00 from A. B. Hill, in full of account.
8. Paid office salaries, $100.00.
Received for sundry cash sales to date, $110.00.
12. Paid for advertisement in local paper, $20.00.
15. Received $90.00 from E. C. Cline, to apply on account.
18. Paid $400.00, for a cash purchase of merchandise.
22. Received $300.00, for sundry cash sales to date.
24. Paid office salaries, $100.00.
26. Paid E. H. White in full for invoice dated Jan. 15th, $250.00.
28. Received $70.00 from J. B. King, to apply on account.
30. Received $140.00, for sundry cash sales to date.
Paid O. P. King in full for invoice dated Jan. 20th, $480.00.
31. Paid $50.00, for delivery service to date.

Nature of the Cash Record

The student must understand thoroughly that each side of the cash book is a complete journal in itself, since the total debits and credits recorded there are always equal. An analysis of a cash receipt and a cash payment will make this clear. If $500.00 is received from H. L. Cohagen, to apply on account, the entry in journal form is:

Cash	$500.00	
H. L. Cohagen		$500.00

In this form the equality of the debit and credit resulting from the transaction is clearly shown. If this same transaction is recorded in the cash book there will be a credit to the account of H. L. Cohagen the same as if the transaction were recorded in the journal. Instead of an individual debit to the Cash account for the $500.00 received, however, there will be a debit to the Cash account for the total cash received which will equal the total of the various individual credits made to the various accounts indicated as shown in the illustration. It can be easily seen, therefore, that the total debits posted from the debit side of the cash book are equal to the total credits posted therefrom.

The same is true of the credit side of the cash book. If $50.00 is paid for some service contributing to the making of sales, the journal entry would be:

Selling Expenses	$50.00	
Cash		$50.00

If this entry is recorded on the credit side of the cash book there will be an individual debit to Selling Expense and the $50.00 cash credit will be included in the total credited to cash at the time the cash book postings are completed. The various debit items posted from the credit side of cash book are balanced by the one total credited to Cash, thus maintaining the equality of debits and credits the same as if the transactions had been entered and posted from the general journal. The student must always remember that each side of the cash book performs the functions of a journal and that the same analysis of transactions is afforded by the cash book as by the general journal. In other words, the use of these special journals does not vitiate in any way the principles discussed in the preliminary treatment of books of original entry, but rather affords a further application of them.

Cash Receipts

Date		L.F.	Account Credited	Explanation	Amount	Total Cash Dr.
192- Jan.	1		H. L. Cowan, Prop.	Investment	5000	
	6		A. B. Hill	In full of acct	80	
	8		Sales	Cash sales	110	
	15		E. C. Cline	On acct.	90	
	22		Sales	Cash sales	300	
	28		J. B. King	On acct	70	
	30		Sales	Cash sales	140	
	31		Cash, Dr.			5790
						5790
Feb	1		Balance			4140.

Illustration No. 11—Debit Side of the Cash Book

Posting from the Cash Book

If the student keeps in mind the analysis of cash receipts and cash payments given in the preceding paragraph, he should experience no difficulty in posting from the cash book.

Each amount entered in the "Amount" column on the debit side of the cash book is posted to the credit of the account written in the "Accounts Credited" column on the same line with it. The total of cash receipts is posted to the debit side of the Cash account at the end of the month, or when a Trial Balance is to be taken.

Each amount entered in the "Amount" column on the credit side of the cash book is posted to the debit of the account written in the "Accounts Debited" column on the same line with it. The total of cash disbursements is posted to the credit side of the Cash account at the end of the month, or when a Trial Balance is to be taken.

It is desirable that the debits and credits to personal accounts be posted daily. The other items can be posted at the same time, but the posting of these may be omitted until the totals are posted at the end of the month, or when a Trial Balance is to be taken. After all entries in the cash book have been posted at the end of

Cash Payments

Date		L.F.	Account Debited	Explanation	Amount	Total Cash Cr.
192-						
Jan.	2		Selling Expenses	City and state license	50	
	3		Furniture & Fixtures	Typewriter, desk, chair	200	
	8		Administrative Exp.	Office salaries	100	
	12		Selling Expenses	Advertisement	20	
	18		Purchases	Cash purchase	400	
	24		Administrative Exp.	Office salaries	100	
	26		E. H. White	Invoice 1/15	250	
	30		O. P. King	Invoice 1/20	480	
	31		Selling Expenses	Delivery service	50	
			Cash Cr.			1650
			Balance			4140
						5790

Illustration No. 12—Credit Side of the Cash Book

the month, the cash book is footed and ruled as in Illustrations Nos. 11 and 12.

Summary

The discussion of the books of original entry given in this and the preceding chapter has been primarily for the purpose of illustrating the nature and functions of these records and their relation to the accounts and the accounting reports. Simple forms, which illustrate the principles underlying their construction and which would be suitable for use in small mercantile businesses, have been given. These forms have been made simple in order that they might be readily comprehended by the beginning student. The thing of primary importance for him to understand is the relation of the records of original entry to the accounts—that the nature of the information desired in the accounts determines the nature of the information recorded in these records, and the nature of the information recorded in them determines their construction. To repeat once again: the nature of the information recorded in the accounts is determined by the information that the owner or manager desires in the conduct of his business.

QUESTIONS FOR CLASS DISCUSSION

1

Explain the advantages of the cash receipts journal as a means of recording cash receipts.

2

Explain the advantages of the cash disbursements journal as a means of recording cash payments.

3

When these two journals are combined, what do they constitute?

4

What is the essential information to be recorded on the debit side of the cash book?

5

What is the essential information to be recorded on the credit side of the cash book?

6

Explain the posting of the debit side of the cash book.

7

Explain the posting of the credit side of the cash book.

8

Explain how the cash book is balanced. How often should it be balanced?

9

How can the correctness of the balance be proven?

10

In what way does the use of the cash book affect the Cash account?

LABORATORY MATERIAL

The purpose of the following exercises is to give practice in recording transactions in the cash receipts and cash disbursements journals and the cash book, posting from the cash book, and further practice in taking a Trial Balance.

Exercise No. 66

Feb. 1. J. W. Hays invested $1,276.80 cash.
2. Received $150.00 from T. C. Blue, to apply on account.
3. Paid office rent for month of February, $40.00.
4. Received $80.00, for cash sales.
Paid N. A. Erickson $60.00, to apply on account.
6. Received $120.00, for cash sales.
8. Paid L. A. Slope $90.50, to apply on account.
9. Received $90.00 from K. C. Lowly, in payment of bill of Jan. 10th.
10. Paid drayage on merchandise purchased, $22.50.
11. Paid J. B. Brooks $124.00, to apply on account.
14. Received $69.75, for cash sales.
16. Received $170.00 from S. B. Johns, in payment of invoice of Jan. 10th.
18. Paid $45.00, for office help.
20. Paid C. T. Lilly $146.00, to apply on account.
22. Purchased merchandise for cash from N. C. Riley, $128.00.
23. Sold H. D. Thompson, for cash, merchandise, $47.85.
24. Received $210.00 from L. M. Lind, to apply on account.
25. Paid salesman's expenses, $76.00.
Received $52.50, for cash sales.
27. Paid $32.80, for freight and drayage on merchandise purchases.
Paid clerk hire, $40.00.
28. Paid for advertising, $22.50.

Instructions: 1. Write "Cash Receipts" at the top of a sheet of journal paper and "Cash Disbursements" at the top of another sheet, and record the above transactions on these two sheets of paper.

2. Foot and rule these sheets of paper as in the illustrations of the cash receipts journal and the cash disbursements journal on pages 173 and 177 respectively.

3. Post the entries in the cash receipts journal and the cash disbursements journal to a sheet of ledger paper, allowing four lines for each account.

4. Take a Trial Balance.

Exercise No. 67

The following are the cash transactions of A. J. Sturges for the month of March:

Mar. 1. A. J. Sturges invests $2,500.00 cash in the retail shoe business.
2. Bought from M. S. Comstock, for cash, stock of shoes invoiced at $1,452.75.
3. Paid telephone service for three months in advance, $20.00.
Received $127.42 for cash sales.
5. Paid clerk hire, $15.00.
6. Received $11.00 from J. C. Williams, in full of account.
8. Paid Wolverine Shoe Co. $490.25, in full of account.
9. Received $267.50 for cash sales.
12. Paid clerk hire, $15.00.
15. Paid Bradley & Metcalf $381.50, in full of account.
16. Received $5.25 from A. B. Clifford, in full of account.
18. Paid $8.25, for stamps and stationery.
19. Paid clerk hire, $15.00.
22. Received $23.00 from B. L. Dobell & Co., in full of account.
24. Received $9.00 from K. C. Best, in full of account.
26. Received $536.75 for cash sales.
Paid clerk hire, $15.00.
27. A. J. Sturges withdrew $50.00 for personal use.
29. Received $4.00 from L. A. Ring, in full of account.
31. Paid rent, $50.00.
Paid Evans Shoe Co. $78.50, in full of account.
Received $360.50 for cash sales.

Instructions: Follow instructions given under Exercise No. 66.

Exercise No. 68

The following are the cash transactions of C. A. Arnold for the month of May:

May 1. C. A. Arnold invested $2,500.00 cash in the retail hardware business.
2. Bought from J. T. Ludlow, for cash, stock of hardware invoiced at $1,691.42.
3. Paid telephone service for three months, $20.00.
Received $69.85, for cash sales.
5. Paid clerk hire, $10.00.

May 6. Received $7.50 from E. M. Miller, in full of account.
Paid Moore & Moore, in full of account, $496.81.
9. Received $275.40, for cash sales.
12. Paid clerk hire, $10.00.
15. Paid Pickering Hardware Co. $387.65, in full of account.
16. Received $5.25 from William A. Wallace, in full of account.
18. Paid $8.25, for stamps and stationery.
19. Paid clerk hire, $10.00.
22. Received $33.10 from J. C. Wilson & Co., in full of account.
24. Received $8.45 from D. T. Sinton, in full of account.
26. Received $581.92, for cash sales.
Paid clerk hire, $10.00.
27. C. A. Arnold withdrew $50.00, for personal use.
29. Received $2.50 from G. L. Frye, on account.
31. Paid rent, $50.00.
Paid Cline Hardware Co. $168.42, on account.
Received $361.92, for cash sales.

Instructions: 1. Record the above transactions on the inside of a double sheet of journal paper ruled as Illustrations Nos. 11 and 12.

2. The cash transactions in this exercise represent the receipts and payments in connection with the purchases and sales in Exercise No. 65. Post these entries to the accounts obtained after completing Exercise No. 65.

3. Take a Trial Balance.

Exercise No. 69

Prepare a Balance Sheet and a Statement of Profit and Loss from the Trial Balance prepared in Exercise No. 68. Inventory of merchandise $4,750.00.

Exercise No. 70

Record the transactions given in Exercise No. 45 in a purchases journal, sales journal, and cash book; when entering the purchases, use the date of the transaction as the date of the invoice; number the sales and purchases in numerical order, beginning with 1; post these entries (see Exercise No. 45), take a Trial Balance, and prepare a Balance Sheet and Statement of Profit and Loss (inventory $1,000.00). Compare the results of this exercise with Exercises Nos. 45 and 60.

CHAPTER XIII

THE MODERN USE OF THE GENERAL JOURNAL

Effect of Special Journals on the General Journal

In discussing the books of original entry in Chapter X, the general journal was explained and illustrated as a posting medium for transactions of all kinds. It was stated, however, that it is not so employed in modern practice and was thus used at the time merely as a means of illustrating in a simple way the nature and function of books of original entry and the method of recording transactions in them. In Chapters XI and XII special journals for the recording of transactions with purchases, sales, and cash were given. These journals were discussed because they are the ones in most general use and are typical of all special journals in so far as the principles governing their construction and use are concerned. Other journals of a special nature will be discussed in subsequent chapters.

By the use of the special journals already discussed, three principal classes of transactions are taken out of the general journal and entered in these separate records. An analysis of the transactions of a mercantile business will show that a majority of its transactions involve the purchase and sale of merchandise, and the receipt and payment of cash. Since this is true, it is interesting to note what transactions are left to be recorded in the journal which, as previously stated, is used to record all transactions which can not be placed in any special journal. For the sake of discussion and illustration the entries recorded in the general journal may be classified as follows:

1. Opening Entries.
2. Current Entries.
3. Adjusting Entries.
4. Closing Entries.

In order that the present use of the general journal as a posting medium may be better understood, each class of entries will be discussed in turn.

Opening Entries

Opening entries are those which are made to record the financial condition of a business at the time of its beginning or organization. The financial condition of a business is shown by its assets and liabilities and the difference between the two or its net worth. The opening entry or entries must record these so that they will, when posted, be properly shown in the accounts. In the case of a sole proprietor his investment may consist entirely of cash, in which case the opening entry may be made in the cash book by a debit to the Cash account and a credit to the Proprietor's account.

In many cases the proprietor has property other than cash, such as land, buildings and merchandise, which he desires to invest in the business. In this case a journal entry is made, since these items can not be recorded in the special journals.

For purposes of illustration it may be assumed that on June 1, 1919, J. J. Reighard invested the following assets in a retail business: cash, $500.00; merchandise, $1,000.00; delivery equipment, $2,000.00; furniture and fixtures, $500.00. By adding the above it will be seen that the total assets of Reighard are $4,000.00, and since he has no liabilities this amount represents his proprietorship, or net worth. Reighard's books may be opened by the following journal entry:

Cash	$ 500.00	
Merchandise Inventory	1,000.00	
Delivery Equipment	2,000.00	
Furniture and Fixtures	500.00	
J. J. Reighard, Proprietor . .		$4,000.00

Although the posting of this entry will show Reighard's financial condition in the accounts, all cash must be recorded in the cash book; therefore, the cash item will be recorded on the debit side of the cash book as well as in the journal. It is readily apparent that this item can not be posted both from the journal and the cash book, for if it is, it would show a cash investment of $1,000.00 instead of $500.00. To avoid this, the individual item is not posted from either book. It is included in the total of $4,000.00 which is posted from the journal to the credit of Reighard's account and it will be included in the total cash posted from the cash book to the debit of the Cash account. Another method of treating this item is not to enter it in the journal, but only in the cash book and to post it from the cash book. The advantage of entering it in the journal is that the total invest-

ment is shown in one place. Both methods give the same result so far as the effect on the accounts and the reports is concerned.

In some cases the proprietor may have liabilities which he desires the business to assume. In this case these liabilities must be shown as part of the journal entry. If Reighard owes $500.00 to creditors, his opening entry would be:

Cash	$ 500.00	
Merchandise Inventory	1,000.00	
Delivery Equipment	2,000.00	
Furniture and Fixtures	500.00	
Accounts Payable		$ 500.00
J. J. Reighard, Proprietor . .		3,500.00

The above example illustrates the nature of the opening entries for a sole proprietor. In the case of a partnership and a corporation the same principles are followed, but the entries may be somewhat more complicated. The method of making such entries will be explained and illustrated in subsequent chapters.

Current Entries

As previously stated, the general journal is used to record all transactions which can not be recorded in any of the special journals. It is impossible to discuss all the various kinds of transactions which may arise during the fiscal period in connection with different businesses, but a few of those which are most prevalent will be explained and illustrated.

In discussing the purchases and sales journal we have seen that they are used only to record purchases and sales of merchandise. In every business it is necessary from time to time to purchase certain property to use in the conduct of the business; likewise discarded property or property no longer needed in the conduct of the business may be sold. If these purchases and sales are for cash they are recorded in the cash book, but if they are on account, the only means of recording them is in the journal. For instance, if $300.00 worth of office equipment is purchased on account from the Equipment Corporation of America it is necessary that the asset account with Furniture and Fixtures be debited and the account of the Equipment Corporation of America be credited. This is accomplished by the following journal entry:

Furniture and Fixtures	$300.00	
Equipment Corporation of America		$300.00

In the case of a sale of property on account, the reverse entry is made in the journal, the account of the customer being debited and the property account credited.

It has been explained in a previous chapter that when goods are sold on account a record of the transaction is made in the sales journal, and that when cash is received in payment a record is made of the cash received on the debit side of the cash book. Written promises or notes, however, are sometimes received in payment of merchandise sold, the note being given at the time of the sale or later, in payment of the oral promise previously given. In either case, it is customary to record the sale of the merchandise as a sale on account in the sales journal and record the receipt of the note in payment separately in the general journal. If \$100.00 worth of merchandise is sold to James Smith on account there would be an entry in the sales journal by which Smith's account would be debited and Sales account credited for \$100.00. If a 30-day note is accepted from James Smith when the account is due, an entry would be made in the general journal as follows:

Notes Receivable	\$100.00	
James Smith		\$100.00

The effect of this entry is to cancel the charge made to the account of James Smith at the time of the sale and to show the claim of the business against James Smith in the form of a written claim as reflected in the Notes Receivable account, instead of showing it as an oral claim by a debit to his personal account as formerly.

When notes are issued by the business in payment of merchandise purchased, a procedure similar to that outlined above is followed. The purchase is recorded in the purchases journal as a debit to the Purchases account and a credit to the account of the creditor. When the note is issued in payment, whether immediately or at some future time, a journal entry is made debiting the creditor's account and crediting the Notes Payable account. The effect is to change the form of the obligation of the business to the creditor from an oral to a written promise.

Occasionally errors are made in recording transactions which result in incorrect debits and credits being made to the accounts or in debits and credits being made to wrong accounts. These errors may be discovered later in the fiscal period and frequently the easiest method of correcting them is by means of a journal entry. For instance, there may have been an expenditure of \$100.00 for some

service which should have been charged to Administrative Expenses, but the bookkeeper carelessly recorded it as a debit to Selling Expenses and posted it accordingly. The owner, in looking over the Trial Balance, notices that the selling expenses for the month are larger than usual, and very naturally inquires as to the cause. At the same time he may notice that the administrative expenses are smaller than during the previous month, and this may suggest to him that an error has been made. In any case, the bookkeeper, in seeking an explanation of the variation of the selling expenses, will take the items in the Selling Expenses account and trace them through the paging given in the folio column to the book of original entry from whence they were posted. By referring to the explanations given in connection with the transactions recorded in the books of original entry he will ascertain the item which has been improperly charged. If in this manner he locates the entry by which the $100.00 is charged to Selling instead of Administrative Expenses, he must by some means correct the error. Since the administrative expenses are $100.00 too small and the selling expenses are $100.00 too large, the easiest method of correcting the error is to make a journal entry as follows:

Administrative Expenses	$100.00	
Selling Expenses		$100.00
To correct error made in the cash book June 16th, charging $100.00 to Selling Expenses which should have been charged to Administrative Expenses.		

In the case of a correcting entry such as the above, a very complete explanation should be given so that the reason for the entry can be readily determined at any time in the future.

It is necessary to make correcting entries of various kinds during the fiscal period in a business which performs numerous and varied transactions. The above example serves only as an illustration of one type, but from it the student should be able to understand the nature of such entries. In the laboratory exercises given at the end of the various chapters he will find illustrations of other correcting entries.

Although it is impossible to give an inclusive discussion or outline of the transactions of the fiscal period which may be recorded in

the general journal, the following list gives the most prevalent of the entries recorded in this record:

1. Purchases on account, of services and of property other than merchandise.

2. Sales on account, of property other than merchandise.

3. Receipt of property other than cash in payment of obligations due the business.

4. Issuance of property other than cash in payment of obligations owed by the business.

5. Corrections of entries which have been incorrectly recorded or which have been wholly or in part cancelled.

Adjusting Entries

In the discussion of Adjusting Entries in Chapter IX it was explained that at the end of the fiscal period there are certain entries necessary in order to adjust some of the accounts so they will reflect correctly the financial condition of the business. These entries, as explained in the previous discussion, are known as adjusting entries. The student should not confuse these entries with those discussed under the head of correcting entries in the preceding paragraph. The latter are made during the fiscal period to correct an erroneous entry or to record the partial or complete cancellation of a transaction. The former are made at the end of the fiscal period to adjust the value of accounts which reflected accurately the financial condition of the business at the beginning of the period or at the time of their construction, but which have changed in value since that time.

In Chapter IX it was explained that in connection with the accounts of James Madison, the only adjustment necessary is that in regard to the merchandise inventory. The Inventory account must be adjusted so as to show the disposition of the beginning inventory of $1,000.00 and the possession of an ending inventory of $1,450.00. This was accomplished by a debit to the Purchases account and a credit to the Inventory account for the old inventory, and a debit to the Inventory account and a credit to the Purchases account for the new inventory.

The entries for the above adjustments were made at the time of their previous discussion directly in the accounts, since the purpose of the discussion at that time was to show the effect of business oper-

ations on the ledger accounts and since the books of original entry had not been introduced. In subsequent chapters, however, the use of books of original entry as posting mediums through which the entries to ledger accounts are passed has been explained. The advantage of having all entries recorded in some book of original entry prior to their entry in the accounts has been emphasized. In conformity to that principle adjusting and closing entries are recorded in the journal, and from there posted to their respective accounts. The chief advantage of this method is that all entries in the ledger can be traced back to their original source and an explanation therefor obtained. It also minimizes errors and greatly facilitates the finding of any which may occur.

The adjusting entries required in connection with the accounts of James Madison, when made in journal form, will be as follows:

31		
Purchases	$1,000.00	
Inventory		$1,000.00
To transfer the inventory of Dec. 1, 192.., to the Purchases account.		
31		
Inventory	1,450.00	
Purchases		1,450.00
To record the inventory of Dec. 31, 192...		

When these entries are posted, the accounts will show the same results as in the illustrations given in Chapter IX.

The Closing Entries

In Chapter IX we saw that certain entries are necessary at the end of the fiscal period in order to summarize the results of the period and to make the Income and Expense accounts on the ledger show the same results as the summary shown on the Statement of Profit and Loss. It was explained that the closing of the imaginary ledger of James Madison would involve the following: the transfer of the balance of the Purchases account to the debit of the Sales account; the transfer of the balance of the Sales account to the credit of the Profit and Loss account; the transfer of the balances of the Selling Expense and Administrative

Expense accounts to the debit of the Profit and Loss account; and the transfer of the balance of the Profit and Loss account to the credit of the Proprietor's account. The reasons for these entries have been explained in the previous discussion, so need not be repeated here.

For the same reasons given with reference to adjusting entries, the closing entries should be recorded in the journal and posted from there to the ledger accounts.

The journal entries for closing the ledger of James Madison are as follows:

31		
Sales	$1,125.85	
Purchases		$1,125.85
To transfer cost of goods sold to the Sales account.		
31		
Sales	435.89	
Profit and Loss		435.89
To transfer gross profit on sales to the Profit and Loss account.		
31		
Profit and Loss	140.00	
Selling Expenses		140.00
To transfer Selling Expenses to the Profit and Loss account.		
31		
Profit and Loss	145.73	
Administrative Expenses		145.73
To transfer Administrative Expenses to Profit and Loss account.		
31		
Profit and Loss	150.16	
James Madison, Prop. . . .		150.16
To transfer net profit for the fiscal period to the Proprietor's account.		

When the above entries are posted the accounts will show the same results as in Chapter IX, where the entries are made directly in the accounts.

QUESTIONS FOR CLASS DISCUSSION

1

Arthur Robey starts in the hardware business and at first records all his transactions in a journal. As his business increases he installs a purchases journal, a sales journal, and a cash book. He wonders if he should retain the general journal; and if so, for what entries he would use it. Mr. Robey asks your advice. What is your reply?

2

On January 1, 1919, Richard Field opens a grocery store. His assets are as follows: Cash, $1,000.00; Merchandise Inventory, $500.00; Fixtures, $200.00; Total Assets, $1,700.00.

Advise Mr. Field where he should enter the above items. What debits and credits should he make? What are these entries called?

3

Tell Mr. Field the correct way of recording and posting the cash item in Question No. 2.

4

In the course of business Richard Field purchases, on account, a cash register for $100.00. He sells his former cash drawer, which now is unnecessary, to Joe Larson, on account, for $5.00. Where should Mr. Field record these transactions?

5

Mr. Field gives Reid & Co. a note for $150.00 on account. Where should he record this transaction? Give the correct entry.

6

The bookkeeper of the firm of Thomas & Healy has carelessly charged $150.00 to Selling Expenses that should have been charged to Administrative Expenses. The error is found and a correction must be made. Where should this correction be recorded? What is the technical name of such an entry?

7

On January 1, 1919, N. R. Olson, operating a grocery store, has an inventory of $4,000.00. On December 31, 1919, he has an inventory of $5.000.00. How is the disposition of the beginning inventory and the possession of the ending inventory shown? Where should these entries be made? What are they called?

8

On December 31, 1919, N. R. Olson desires to summarize the results of the period. In addition to other accounts on his ledger, he maintains the following: Purchases, Sales, Selling Expenses, Administrative Expenses, Profit and Loss, and Proprietor's accounts. Briefly explain to Mr. Olson the process of summarizing. Where do you make the necessary entries, and what are these entries called?

9

N. R. Olson has these entries recorded in his general journal:

January 1		
Cash	$1,000.00	
Merchandise Inventory	4,000.00	
Delivery Equipment	1,000.00	
Accounts Payable		$1,000.00
N. R. Olson, Prop.		5,000.00
5		
Furniture and Fixtures	200.00	
National Equipment Co. . .		200.00
10		
Notes Receivable	100.00	
William Farley		100.00
15		
Selling Expenses	150.00	
Administrative Expenses . .		150.00
31		
Purchases	1,200.00	
Merchandise Inventory . . .		1,200.00
Sales	5,000.00	
Purchases		5,000.00
Profit and Loss	1,000.00	
Administrative Expenses . .		1,000.00

Explain the purpose of each of the above entries and state whether it would be termed an opening, correcting, current, adjusting, or closing entry.

10

Explain the two methods by which the adjusting and closing entries may be made. Which method is preferable? Why?

LABORATORY MATERIAL

The purpose of these exercises is to give practice in making entries in the general journal.

Exercise No. 71

The Trial Balance of James Madison, December 31st, given in Chapter VII, is as follows:

Cash	$ 252.00	
Notes Receivable	27.92	
L. S. Lyon	47.81	
A. C. Hodge	56.26	
N. W. Barnes	98.95	
E. R. Lambert	96.91	
J. H. Bishop	156.16	
Merchandise Inventory	1,000.00	
Store Furniture	220.00	
Delivery Equipment	400.00	
Notes Payable		$ 60.85
M. L. Rose		240.00
G. B. Brown & Co.		465.00
James Madison, Prop.		1,940.00
James Madison, Personal	50.00	
Sales		1,561.74
Purchases	1,575.85	
Selling Expenses	140.00	
Administrative Expenses	145.73	
	$4,267.59	$4,267.59

Madison's inventory of merchandise on December 31st is $1,450.00.

Instructions: 1. On loose ledger paper open the accounts given in Madison's Trial Balance. Allow five lines for each account.

2. On a sheet of journal paper make the entries necessary to adjust and close the ledger of Madison.

3. Post these entries and rule the accounts that balance.

4. Compare the accounts affected by the above entries with the same accounts given in Chapter IX, where the adjusting and closing entries were made directly in the accounts.

Exercise No. 72

The Trial Balance of D. C. Brown, on December 31, 1919, is as follows:

Cash	$ 450.00	
Accounts Receivable	2,150.00	
Merchandise Inventory, Jan. 1st	1,500.00	
Office Furniture	200.00	
Delivery Equipment	350.00	
Notes Payable		$ 200.00
Accounts Payable		1,800.00
D. C. Brown, Proprietor		1,970.00
D. C. Brown, Personal	120.00	
Sales		8,000.00
Purchases	6,000.00	
Selling Expenses	340.00	
Administrative Expenses	860.00	
	$11,970.00	$11,970.00

Instructions: 1. Make a Balance Sheet and a Statement of Profit and Loss. Inventory of Merchandise Dec. 31st, $1,200.00.

2. On loose ledger paper open the accounts given in Brown's Trial Balance. Allow five lines for each account.

3. On a sheet of journal paper make the entries necessary to adjust and close Brown's ledger.

4. Post these entries and rule the accounts that balance.

Exercise No. 73

On a sheet of journal paper make the entries necessary to adjust and close the ledger of J. B. Small as prepared in Exercise No. 56. Post these entries and rule the accounts that balance.

Exercise No. 74

On a sheet of journal paper make the entries necessary to adjust and close the ledger of W. D. King as prepared in Exercise No. 57. Post these entries and rule the accounts that balance.

Exercise No. 75

On a sheet of journal paper make the entries necessary to adjust and close the ledger of A. M. Chapman as prepared in Exercise No. 58. Post these entries and rule the accounts that balance.

CHAPTER XIV

BUSINESS VOUCHERS AND FORMS

Purpose of the Voucher

In the preceding chapters we have seen how business transactions are analyzed and the result of the analysis recorded in the books of original entry. Since the bookkeeper who makes the record very rarely performs the transactions which are to be recorded, it will be realized that there must be some means by which he obtains the information necessary to make the proper entries. This is well illustrated in a large department store where hundreds of clerks are making sales in the different departments of the store, the buyers are purchasing goods in the various source markets of the world, cash is being received in the different departments as a result of sales, as well as from other sources, and being sent to the cashier, and cash is being paid out under the direction of the treasurer. The accounting department has no personal contact with these various transactions, yet it must record them so as to show their result on the financial condition of the business.

The same condition is true on a smaller scale in practically every business. Those who record the transactions perform few, if any, of them, so they must depend on having communicated to them by some means the information necessary to enable them to make the record. Even if the same person performs the transaction and makes the record, he is usually unable to do both simultaneously, hence he must have some memorandum of the transaction to use as a basis of the record to be made later. Consequently there are certain forms or papers used in business practice which provide the information in reference to transactions necessary as a basis for their entry. These forms are frequently referred to in accounting as Vouchers. A voucher may be defined briefly as the written evidence of a business transaction.

In addition to serving as a basis of the entries made in the records, many vouchers are used to facilitate the operation of the transactions of which they bear evidence. There are also forms and papers which are used solely for the latter purpose and are not used as vouchers

for entries at all. Since they are all necessary to the performance of the operations which are recorded in the records, they will be discussed together, although it is in the voucher as a basis of the accounting entry that the present discussion is primarily concerned.

Classification of Vouchers and Forms

The vouchers and forms which are used in business practice are so numerous and so varied that only the most important can be discussed and no all-inclusive classification can be given. For the purposes of the present discussion, however, the following classification will serve:

1. Vouchers used in connection with the purchase and sale of merchandise.
2. Negotiable vouchers which have certain characteristics not common to vouchers or business forms in general and are used primarily in the settlement of obligations.
3. Miscellaneous vouchers and forms, which include all those not in the first two classes.

The Merchandise Invoice

When merchandise is sold, it is customary for the seller to prepare an itemized statement of the goods sold which he gives or sends to the customer. At the same time that he makes the original for the purchaser the seller usually makes one or more copies which he retains for his own use. This statement, both from the viewpoint of the buyer and the seller, is known as an Invoice. It is an itemized statement of goods bought or sold, and should contain the name and address of both buyer and seller, the date of sale, the terms of sale, the method of shipment, if any, and the quantities, kinds, and prices of the merchandise. It may, of course, contain other information, if desired. The method which may be employed in using the invoice as a basis of the purchases and sales records will be discussed briefly.

When merchandise is bought the purchases invoice is usually received before the merchandise arrives. If so, the invoice is filed until the merchandise is received, when a comparison is made to see that the quantities received agree with those listed on the invoice. The prices, extension, and total are also verified, and if found correct an

entry is made in the purchases journal as described in a preceding chapter. Each invoice is numbered when received and its number recorded in the folio column of the purchases record. After the invoice is entered, if it represents a credit purchase, it is filed in the "Unpaid Invoice" file under the date when it should be paid. On that date it is removed from the file and given to the party who is responsible for its payment. After it has been paid and the proper entry made in the cash book, it is stamped as paid, and filed in the "Paid Invoice" file, so as to be available for future reference if desired.

The handling of the sales invoice, or the "sales ticket" as it is frequently called in retail stores, varies to a considerable degree, depending upon the internal organization and routine of the particular business. In a wholesale business one or more copies of the invoice sent to the purchaser is made, and one of these is sent to the accounting department from which an entry is made in the sales record. When the invoice is paid the accounting department may receive a copy of the invoice stamped "paid" or it may receive the remittance itself or may be notified by a special business form used for the purpose. In any case an entry is made in the cash record for the cash received. The invoice may be stamped as paid if desired and is

(*Continued on page 201*)

BRANDS
&
WINORR
VESPER
WILTON

THE WINORR CANNING CO.

FORMERLY OF THE PRESSING & ORR CO

PACKERS OF

HIGH GRADE CANNED FOODS

No. 29778

Car No. 76492

Car Initial N. & W.

CIRCLEVILLE, OHIO, Nov. 24, 192

SOLD TO L. M. Park & Co

Indianapolis, Ind

TERMS—1½ per cent for cash in 10 days or 60 days acceptance net

CASES	DOZENS	SIZE	ARTICLE	PRICE	AMOUNT		TOTAL	
25	3	10	Winorr Corn	2^{00}	150			
25	3	10	Vesper Corn	2^{50}	187	50		
25	3	10	Wilton Corn	3^{00}	225			
25	2	14	Superior Quality Tomatoes	1^{50}	75			
50	3	10	Fancy Peaches	2^{25}	337	50		
50	2	12	Daisy B. Beans	1^{75}	175		1150	

Illustration No. 13—Invoice

then filed where it can be obtained for future reference, if necessary. Its number is entered in the folio column of the sales record and this serves as a means of identifying it with the transaction to which it pertains.

In a retail business cash sales usually constitute a large item and the duplicate sales tickets representing these are totaled at the end of the day, checked against the cash received, and entered as a total in the records. The credit sales ticket may be entered in a sales journal as separate items and posted from there to the customer's accounts, or they may be posted directly from the sales tickets to the customer's accounts and then entered in the records as a total only. In some retail stores no accounts are opened with individual customers, the credit sales being posted in total and the tickets filed under the customer's name. When the customer pays his account the proper entry is made in the cash record and the sales tickets are removed from the file and given to the customer or destroyed. At any time the tickets filed under the customer's name show the amount he owes. If it is the practice of the business to mail statements to customers at the end of the month showing the amount they owe, these would be made from the tickets in the file.

W. O. Crosswhite

BOUGHT OF

THE C. L. GREENO COMPANY,

325 MAIN STREET,

'Phone Main 1461. CINCINNATI, O.

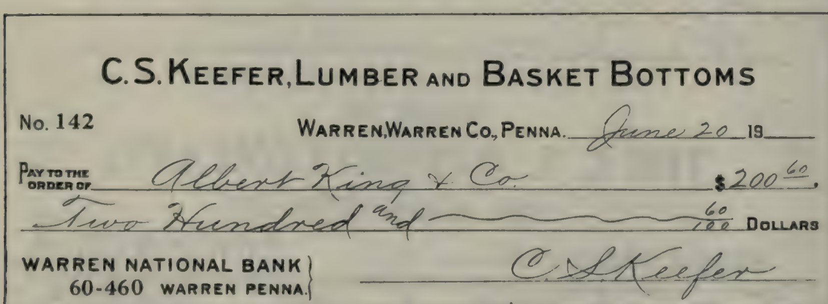
No.	Sold by	Date	Am't Rec'd
0850	Cox	2/18/20	Charge

STOCK No.	ITEMS	PRICE	AMOUNT
10	yds Linoleum	4.50	45.00
2	6x9 Rugs	42.25	84.50
			129.50

Illustration No. 14—Sales Ticket

Negotiable Instruments

It has been explained previously that the operations of a business consist mainly in the making of business transactions, and that business transactions consist in the exchange of values. This exchange of values is facilitated by the use of certain business papers which serve as a medium of exchange. The nature of these business papers probably can be best explained by an illustration. When goods are sold, there may be received from the customer in exchange for the goods one of three things: cash, a written promise, or an oral promise. If cash is received from a customer, it may be currency or an order on his bank to pay to the order of the one from whom he has made the purchase the amount required to pay for the merchandise. It is possible to make this demand of the bank because the one who makes the order has deposited with the bank certain money with the understanding that the bank will pay this on his order. The process by which this money is left with the bank and such agreement established will be explained in the next chapter. If C. S. Keefer is the buyer and Albert King & Co. the seller, and the payment is made by check, the order would be in the form of Illustration No. 15. This written order is termed a Check.


C. S. KEEFER, LUMBER AND BASKET BOTTOMS

No. 142 WARREN, WARREN CO., PENNA. June 20 19__

PAY TO THE ORDER OF Albert King & Co. $200 60/100

Two Hundred and 60/100 DOLLARS

WARREN NATIONAL BANK
60-460 WARREN PENNA.

C. S. Keefer

Illustration No. 15—Check

But, instead of cash a written promise to pay cash at some future date may be received in exchange for goods sold. Such a written promise, if made in proper form, is known as a Note. When a note is received from another in payment of merchandise, it is termed a note receivable by the business receiving it. When a note is issued in payment of merchandise it is known as a note payable by the business issuing it. It can be readily seen that the

same note is always a note receivable to one party and a note payable to another. In form a note may be as follows:

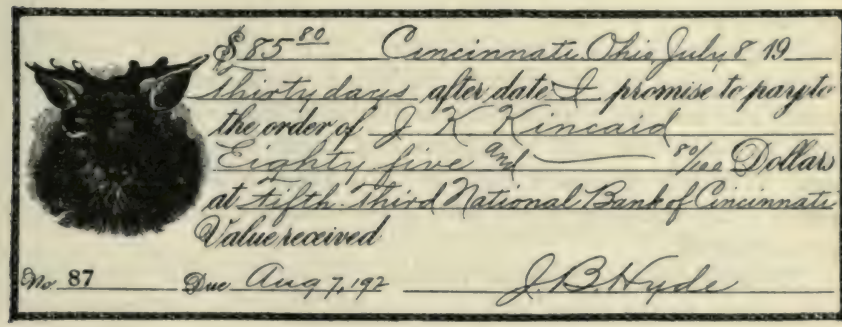

$85 80/100 Cincinnati Ohio July 8 19
Thirty days after date I promise to pay to
the order of J. K. Kincaid
Eighty five and 80/100 Dollars
at Fifth Third National Bank of Cincinnati
Value received
No. 87 Due Aug 7, 19 J. B. Hyde

Illustration No. 16—Note

It will be readily seen that if a note, say for thirty days, is given in payment of merchandise at the time of the sale, the relations between the purchaser and seller with reference to this sale are not ended. At the end of the thirty days the purchaser must pay the note, and this he may do by giving the seller currency, but most likely he will give him a check which will involve the process previously described. In the same manner, if an oral promise to pay for the merchandise in thirty days is given at the time of the sale, one or both of the business forms discussed above may be involved before final payment is made. It is very probable if cash payment is made at the end of the thirty days that it will be by means of a check. It is likewise possible that on the date of payment of the oral promise a written promise or note will be given for an extension of time, and later a check given in payment of the note. The latter situation is not a desirable one from the viewpoint of the seller and does not occur frequently, but is a practice sometimes followed by firms unable to pay their open accounts promptly.

It will be realized, of course, that each business is purchasing goods as well as selling them, and that usually the same methods are used in the payment of goods purchased by the firm as are used by the customers of the firm in paying for goods bought. In fact, since the buying and selling of goods are but the opposite sides of the same process, this must of necessity be true. Not only are such business papers as the check and the note used in the purchase and sale of merchandise, but they are used in the same manner in the purchase and sale of services. The employees of the business are usually paid

for their services by means of checks, and even if they are paid in currency, a check is written for the amount needed to pay them, and the amount obtained from the bank where the company keeps its funds, and this currency is then distributed to the employees. If building and land are purchased, they will be paid for by means of a check, or they may be partially paid by a check and partially by a note. The method of procedure in the latter case will be discussed fully in connection with mortgages and bonds in subsequent chapters. It is only necessary here for the student to see that the note assists in the exchange which takes place when the building and land are purchased.

From the above discussion it should be apparent how such business papers as the check and the note facilitate the performance of transactions, and that some knowledge of their nature and function is necessary in order to make a proper record of the transactions of which they serve as evidence. Such business papers, which are used as a medium of exchange, are known both in law and accounting as Negotiable Instruments. They possess certain characteristics and must comply with certain legal requirements not common to other business vouchers and forms, so it is necessary to notice their nature a little more definitely than is indicated above.

Requisites of Negotiable Instruments

The extensive use of negotiable instruments as a medium of exchange led quite early in the development of commerce to the regulation by law of their form and use. In the United States there has been adopted what is known as the Uniform Negotiable Instruments Law. The purpose of this law is to make the legal regulations in connection with negotiable instruments uniform in the various states so as to facilitate their use in commerce between the states. This law states certain requisites of a negotiable instrument. Probably their essential characteristics can not be better explained than by a summary of these requisites which is as follows:

1. The instrument must be in writing and signed by the maker or drawer.
2. It must contain an unconditional promise to pay a sum certain in money.
3. It must be payable on demand or at a time which is either fixed or determinable.
4. It must be payable to bearer or to order.

Kinds of Negotiable Instruments

Any written statement which possesses the above requisites is a negotiable instrument. No particular words or no particular order or construction of these words is necessary so long as the requisites are complied with. There is, however, a more or less conventional form in which the various negotiable instruments are prepared, and it is desirable both for the sake of uniformity and of clearness that this form be complied with. There are various kinds of negotiable instruments, each having a different function and at least a slightly different form. Some of the principal negotiable instruments, in addition to the note and check which have already been discussed and illustrated, are as follows:

1. Drafts.
2. Cashier's Checks.
3. Express Money Orders.
4. Postal Money Orders.

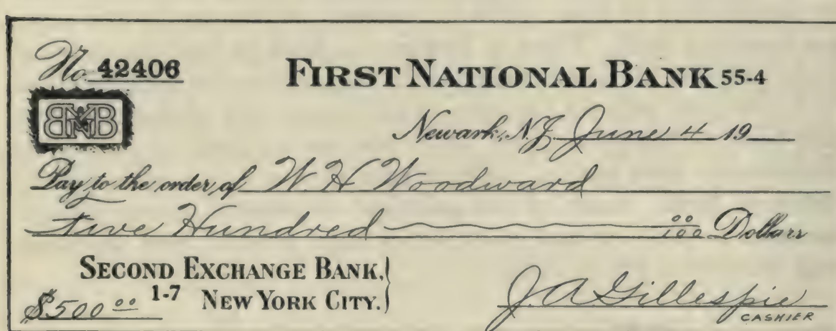
The Draft

A Draft is a written order by which one party directs another to pay a specified sum of money to the order of the first party or to the order of a third party. The bank check is a draft, since it is the written order of the party who has the deposit in the bank to the bank to pay money to the third party. It is usually treated separately from drafts in general, however, because of its special nature. Drafts other than checks may be classified as:

1. Bank Drafts.
2. Commercial Drafts.

A Bank Draft is really a check drawn by one bank on another, and is evidence that the bank drawing the draft has money on deposit with the bank on which it is drawn. The purpose and use of a bank draft may be explained by means of an illustration: If Henry Jones, who lives in Newark, desires to pay $500.00 to W. H. Woodward, in New York, he may go to his bank in Newark and ask to purchase a New York draft. His bank in Newark will probably have money on deposit with some bank in New York and it will draw a draft on this bank, ordering it to pay W. H. Woodward $500.00. Jones pays his local bank $500.00, and in some cases a little more to pay for the trouble incurred, and receives the draft which he will send to W. H. Woodward. The latter will present it to the bank on

which it is drawn, or will transfer it to some other bank and receive his money as a consequence. The form of a bank draft may be as follows:


No. 42406 FIRST NATIONAL BANK 55-4

Newark, N.J. June 4 19

Pay to the order of W. H. Woodward

Five Hundred $\frac{00}{100}$ Dollars

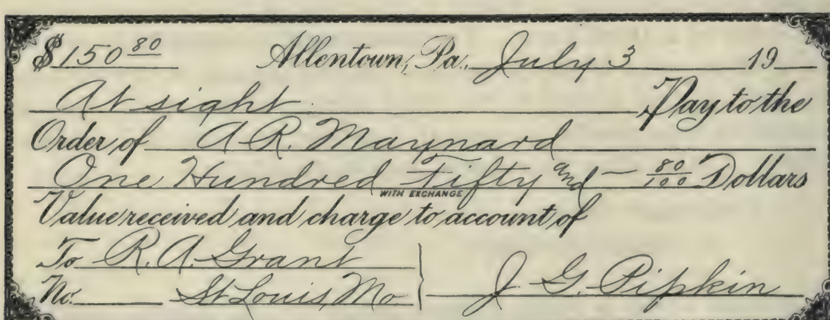
SECOND EXCHANGE BANK, NEW YORK CITY. 1-7

$500.00

J. A. Gillespie CASHIER

Illustration No. 17—Bank Draft

The Commercial Draft, formerly used to a limited extent, is the order of one private individual or firm to another directing him or them to pay a certain sum of money to a third individual or firm. In form it may be as follows:


$150.80 Allentown, Pa. July 3 19

At sight Pay to the Order of A. R. Maynard

One Hundred Fifty and $\frac{80}{100}$ Dollars WITH EXCHANGE

Value received and charge to account of

To R. A. Grant

No. St. Louis, Mo.

J. G. Pipkin

Illustration No. 18—Commercial Draft

The theory on which such a draft is based is that J. G. Pipkin owes A. R. Maynard and that R. A. Grant owes J. G. Pipkin. Maynard presents the draft to Grant and obtains his money and this settles both debts. Such drafts are seldom or never used now, and it is not thought worth while to discuss further their use or to explain the bookkeeping entries which would be necessary to record them. At the present time, instead of using a draft, as suggested above, Pipkin would mail his check to Maynard for the amount he

owes him, and likewise Grant would mail his check to Pipkin. There are several reasons why the use of the "three-cornered" draft, as it is frequently called, is impracticable, the principal reason being that it would be only by the rarest accident that Grant would owe Pipkin the same amount that Pipkin owes Maynard. Under modern business procedure it would also be as difficult for Maynard to collect the draft from Grant as for Pipkin to collect it.

Another form of the commercial draft which is still in use is one by which one party directs the second party to pay a certain sum to the first party. Such a draft may be as follows:

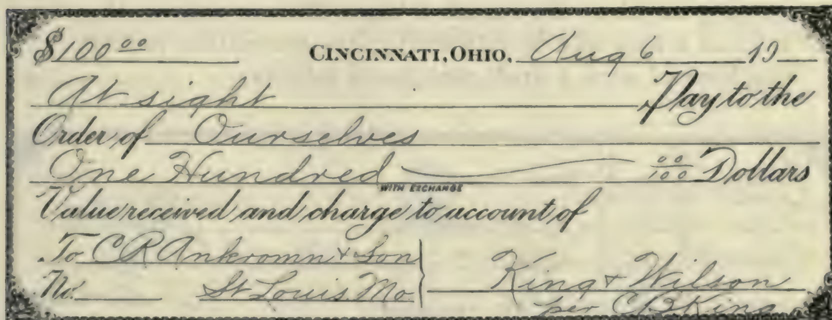

$100.00 CINCINNATI, OHIO, Aug 6 19
At sight Pay to the
Order of Ourselves
One Hundred 00/100 Dollars
WITH EXCHANGE
Value received and charge to account of
To C R Ankromn & Son
No. St Louis Mo
King & Wilson
per C. B. King

Illustration No. 19—Commercial Draft

The above draft indicates that C. R. Ankromn & Son owe King & Wilson $100.00, and the latter desiring to collect this draw a draft in favor of themselves for this amount. This draft they probably give to their Cincinnati bank for collection and their bank forwards it to some St. Louis bank, which notifies Ankromn & Son that a draft is held for collection. Ankromn & Son pay the St. Louis bank and it remits to the Cincinnati bank, which in turn gives King & Wilson credit for that amount.

Instead of drawing the draft in favor of themselves, King and Wilson might have made it payable to the Cincinnati bank. In this case the form of the draft would be the same except the name of the Cincinnati bank would be substituted for the word "Ourselves" in the form given above. The procedure of collecting the draft would be the same as before.

In the above case King & Wilson will not make an entry on their accounting records until they are notified by the bank that the draft has been paid and the proceeds placed to their credit. Then

they would make an entry in the cash book, debiting cash and crediting C. R. Ankromn & Son.

According to time of payment, drafts are classified as Sight Drafts and Time Drafts. Illustrations Nos. 18 and 19 are sight drafts; that is, they are payable "at sight," which means they are payable as soon as they are presented for payment. A time draft is one which is made payable so many days after sight or after date. In the case of such a draft, if the person directed to pay it is willing to do so, he indicates this by writing the word "Accepted" across the face of the draft and signing his name. The acceptance of a draft makes it the written promise of the one accepting it to pay the amount stipulated at the specified time. It is in nature, therefore, the same as a note and is so treated in the accounting records.

The form of such a draft may be as follows:

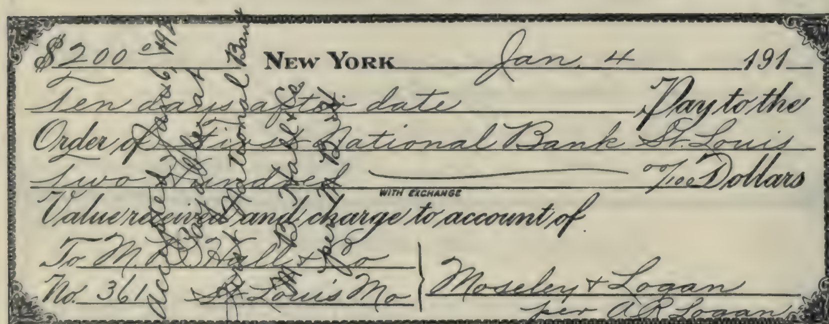

$200 00/100 NEW YORK Jan. 4 191_
Ten days after date Pay to the
Order of First National Bank St. Louis
Two Hundred 00/100 Dollars
WITH EXCHANGE
Value received and charge to account of
To M. B. Hall & Co
No. 361 St. Louis Mo
Moseley & Logan
per A. R. Logan

Illustration No. 20—Accepted Draft

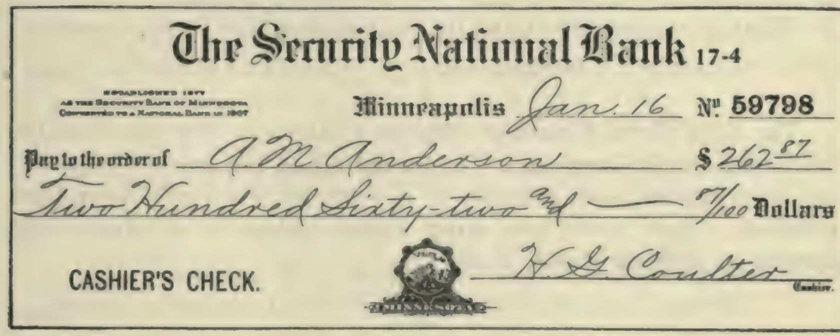
It will be seen by the above illustrations that there are three parties to a draft: the one who makes the request or order, called the *drawer;* the one who is directed to make the payment, called the *drawee;* and the one to whom it is to be paid, called the *payee.* In Illustration No. 20 Moseley & Logan are the drawers and First National Bank is the payee, while M. B. Hall & Co. are the drawees, since they are directed to pay the amount. If M. B. Hall & Co. accept the draft, they become the acceptors, and a draft so accepted is termed an *acceptance.*

As previously stated, an accepted draft is treated in the records as if a note. If it is received by the business the Notes Receivable account is debited and the account of the customer accepting it is credited. If the business accepts a time draft drawn on it by a

creditor, the account of the creditor is debited and the Notes Payable account credited.

Cashier's Check

A Cashier's Check is one drawn on the bank and signed by the cashier. It is used in the payment of collections made for persons who are not customers, or for paying obligations of the bank. In form a cashier's check may be as follows:


The Security National Bank 17-4

Minneapolis Jan. 16 No. 59798

Pay to the order of A. M. Anderson $262.87

Two Hundred Sixty-two and 87/100 Dollars

CASHIER'S CHECK. H. G. Coulter Cashier.

Illustration No. 21—Cashier's Check

Express Money Order

An Express Money Order is a check issued by an express company. It is used as a means of transferring money from one city to another. The one desiring to transfer the money deposits it with the express company and receives the express money order, which is then sent to the party to whom he desires to send the money. The latter presents it to the local office of the express company and receives his money.

Postal Money Order

This is issued by the United States Post Office and is used for the same purpose as the express money order. The postmaster issues the order on the sender's written application. Postal money orders may be cashed at any post office upon proper identification of the holder.

QUESTIONS FOR CLASS DISCUSSION

1

The Brown Mercantile Company employs twenty sales clerks. The bookkeeper records the sales of all of these clerks. How does he obtain the amount of their sales?

2

What is a voucher? Give two purposes which it may serve.

3

The King Retail Company receives a shipment of goods from the Smith Wholesale Company. The box in which the goods are packed has been broken and it looks as if some of the goods have been removed. How could the King Retail Company determine the amount of missing goods, if any?

4

What is the difference between the sales invoice and the sales ticket?

5

The Kansas City Department Store makes numerous cash sales each day. How would they record these sales so as to avoid too much detail in making the record? The same store makes numerous sales on account. How would you suggest that they record these sales to avoid making a separate entry for each sale in the sales journal?

6

James King of Washington, D. C., desires to pay Albert Pick & Company of Chicago, $500.00 for merchandise purchased from the latter. How will he probably make the payment? Prepare the business paper which King will send to Albert Pick & Company.

7

D. D. Sells owes Kenneth MacNeal, on account, $300.00, due this day. Being unable to pay the amount, Sells offers MacNeal a note for thirty days, in settlement of the open account, and MacNeal accepts the offer. Prepare the note which Sells will give to MacNeal.

8

What entry would MacNeal make on his records when he receives Sells' note? In what book of original entry would he make this entry?

9

What are the requisites of a negotiable instrument?

10

James Chapman has a note of a customer which reads as follows: "Thirty days after date I promise to pay to James Chapman five hundred bushels of wheat." Is this a negotiable instrument? Why?

11

What is the difference between a bank draft and a commercial draft?

12

A. M. Anderson owes you $300.00 and sends you a bank draft in payment. What entries would you make on your records?

13

L. S. Lyon owes you $150.00. You draw a thirty-day draft on him. He accepts the draft and returns it to you. What entries would you make on your records?

14

What is a cashier's check? For what purpose is it used?

15

What is an express money order? Illustrate its use.

LABORATORY MATERIAL

Practice Set No. 1

The transactions given below are to be recorded in the general journal, sales journal, purchases journal, and cash book. Loose- leaf journal paper may be used for these records or bound records may be obtained from the publishers.

For convenience and brevity, the letters A, B, C, D, etc., are used to indicate the various commodities bought and sold. The purpose of this exercise is to test the student's ability to apply the principles discussed in previous chapters. Consequently, few explanations are given. If in doubt how to make any entry consult the instructor.

Sept. 1. Erwin C. Cline invested $8,000.00 in the wholesale business at 220 South Main Street.

Rented store and warehouse for one year at a monthly rental of $150.00, payable in advance. (Debit Administrative Expenses account.)

2. Purchased from A. B. Hill, on 30 days' account, 100 A @ $1.00; 200 B @ $1.50.

It is assumed that the information relative to this and succeeding purchases was obtained from the invoices rendered by the seller to the buyer and that these invoices were numbered consecutively beginning with one.

Enter this invoice as No. 1 in the purchases journal. See Illustration No. 9. Use the date of the transaction as the invoice date in this and succeeding purchases. As soon as a purchase on account is entered in the purchases journal, the credit to the Creditor's account should be posted.

3. Paid Gartman & Wagner for the following office furniture: 2 flat-top desks, $200.00; 2 revolving chairs, $25.00. (Debit Furniture and Fixtures.)

4. Purchased of Ralph House, on 20 days' account, 200 A @ $1.25.

Allow five lines for each personal account in the ledger.

5. Purchased from Bertram Harry, on 30 days' account, 80 C @ 50 cents.

6. Sold O. T. Gooch, on 90' days account, 20 A @ $1.25; 50 B @ $1.60.

It is assumed that the information relative to this and succeeding sales was obtained from a carbon copy of the bill sent to the purchaser and these bills numbered consecutively beginning with one.

Enter this sale as No. 1 in the sales journal. See Illustration No. 10. As soon as a sale on account is entered in the sales journal, the debit to the Customer's account should be posted.

Sept. 6. Bought of A. B. Hill, on 30 days' account, 500 C @ 50 cents.

8. Paid for postage and stationery, $5.00. (Debit Administrative Expenses.)

9. Paid clerk hire for week: Donald Sells, $20.00; Harry Swanson, $18.00. Sells' salary will be regarded as an administrative expense. All other salaries will be regarded as selling expense.

10. Purchased as follows:
 John Haywood, 10 days' account, 200 A @ 90 cents.
 Bertram Harry, 20 days' account, 300 B @ $1.50.
 Thomas Hamlet, 10 days' account, 200 C @ 60 cents.

11. Sold as follows:
 John G. Pipkin, 10 days' account, 200 A @ $1.25.
 A. R. Manley, 20 days' account, 150 B @ $2.00.

12. Erwin C. Cline withdrew for personal use $50.00. (Debit Cline's Personal account.)

13. Bought of Albert Mabry & Co., for cash, the following furniture: 2 filing cabinets, $100.00; 1 typewriter table, $10.00.

 Bought of the Underwood Typewriter Company, for cash, one typewriter, $100.00.

Note.—This practice set is continued at the end of Chapter XV. Preserve the records which you have made so that they can be used for the remainder of the exercise.

CHAPTER XV

BUSINESS VOUCHERS AND FORMS (Continued)

Endorsement of Negotiable Instruments

As indicated by the discussion in the preceding chapter, it is frequently necessary to transfer negotiable instruments from one party to another. A legal transfer of a negotiable instrument is effected by endorsement of the payee or holder and delivery to the party to whom transferred. In addition to effecting the transfer of a negotiable instrument, its endorsement serves as a guaranty that it is valid and genuine and that the endorser has legal title thereto. In case the payer fails to pay the instrument when due, the holder can hold the endorser, in case he complies with the legal requirements with reference to presentation and to giving the endorser notice. The law of negotiable instruments is a subject of considerable complexity and for a discussion with reference to the fixing of the endorser's liability, as well as other legal regulations referred to in this discussion, the student must be referred to his course in business law.

There are several forms of endorsement, the most important from the viewpoint of modern business practice being as follows:

James Smith.

1. *Blank.* An endorsement in blank is effected by writing the name of the payee or holder across the back. It has the same effect as making the paper payable to bearer, and the instrument may be transferred by any subsequent holder without further endorsement, but the endorsement of each holder is generally required, for identification.

Pay to the order of C. W. King. James Smith.

2. *Full.* This endorsement is effected by writing "Pay to the order of" above the name of the person or firm to whom it is transferred and signing the name of the payee or holder. The person to whom it is transferred must endorse it before any succeeding holder can obtain title to it. All papers sent through the mail, or to be held for some time by the person who receives them, should be endorsed in full.

Pay to the order of
J. B. Bell,
without recourse.
L. C. Marshall.

3. *Qualified.* The effect of a qualified endorsement is to pass the title without rendering the endorser liable. It is accomplished by writing "without recourse" above the signature of the endorser.

Pay to the order of
The Hyde Park
State Bank,
for collection.
L. C. Marshall.

4. *Restrictive.* The effect of a restrictive endorsement is to constitute the endorsee an agent of the endorser. For instance, notes left at a bank for collection may have "for collection" written above the endorsement. This prevents the paper from being used as the property of the bank.

The endorsement is written on the back of the negotiable instrument, and the first endorsement is by custom placed near the left-hand end of the instrument as illustrated below:

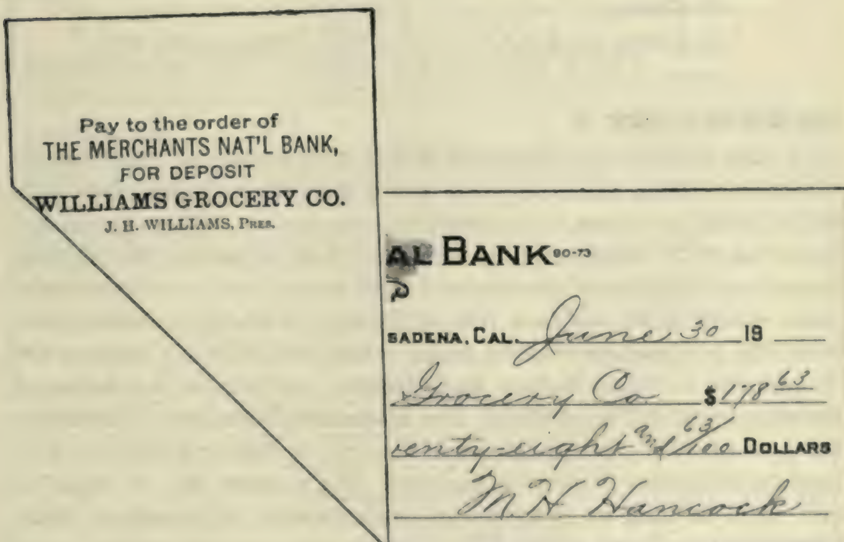


Illustration No. 22—Position of Endorsement

When partial payment is made on a negotiable instrument, a receipt for the same should be written by the holder on the back of the instrument. The date and the amount are all that are necessary; the name of the holder should not be written, for if so it might be interpreted as an endorsement.

A negotiable instrument should be signed by the party or parties responsible for its payment, or by an authorized agent. Each partner in a trading partnership can sign negotiable instruments and bind the firm by his action if the instrument is issued in the regular conduct of the business. In a corporation, such instruments are signed by some officer or employee authorized by the by-laws to do so. When issued by a partnership or a corporation they are signed with the firm name and, in addition, the name of the officer who signs.

Miscellaneous Business Forms

The business forms which may be used in connection with the transactions of a business are so numerous that it is impossible to give an adequate discussion of them. The following, however, are those which are of particular importance to the student at this time:

1. Bill of Lading.
2. Statement of Account.
3. Receipt.
4. Forms Used in Connection with Transactions with a Bank.

The Bill of Lading

In the buying and selling of goods it is necessary that they be transported from place to place, which results in transactions with the railroad or other transportation companies. When goods are delivered to a transportation company for shipment, the shipper receives as evidence of the contract with the railroad a written statement, which is known as a Bill of Lading. The bill of lading contains the contract provisions under which the railroad accepts the freight for carriage, defines its liabilities, and states the duties of the shipper as well as of itself. The Interstate Commerce Commission has prescribed a standard form of the bill of lading which must be used by all transportation companies. The shipper may provide his own form so long as it agrees in content with the standard form. There are two forms of the bill of lading—the *straight*, which is not negotiable, and the *order*, which is negotiable.

The bill of lading is made in triplicate. The original is signed by the shipper and the railway agent, and constitutes the former's receipt for the goods delivered to the railroad. The second, called the shipping order, is signed by the shipper only. It is retained by the railroad as an evidence of its authority. The third copy, which is a duplicate of the first and is signed by the shipper and the agent,

is held by the shipper as a duplicate receipt. It may be sent with the invoice to the customer. In the case of loss or damage to the goods while in transit the original bill of lading is required as a basis of a claim against the railroad.

For use in connection with the Standard form of Straight Bill of Lading approved by the Interstate Commerce Commission by Order No. 787 of June 27, 1908.

3

..................Railroad Company Shippers No............

THIS MEMORANDUM is an acknowledgment that a bill of lading has been issued and is not the Original Bill of Lading nor a copy or duplicate, covering the property named herein and is intended solely for filing or record. Agents No............

RECEIVED, subject to the classifications and tariffs in effect on the date of the receipt by the carrier of the property described in the Original Bill of Lading

at 208 Commerce St..................19 ....., From C. W. KEELAND & CO.,

Third Form of Bill of Lading.

For use in connection with the Standard form of Straight Bill of Lading approved by the Interstate Commerce Commission by Order No. 787 of June 27, 1908.

2

..................Railroad Company Shippers No............

THIS SHIPPING ORDER must be legibly filled in, in Ink, in Indelible Pencil, or in Carbon and retained by the Agent. Agents No............

RECEIVED, subject to the classifications and tariffs in effect on the date of issue of this Shipping Order

at 208 Commerce St..................19 ....., From C. W. KEELAND & CO.,

Second Form of Bill of Lading.

Uniform Bill of Lading--Standard form of Straight Bill of Lading approved by the Interstate Commerce Commission by Order No. 787 of June 27, 1908.

1

B. & O. S. W. Railroad Company Shippers No............

STRAIGHT BILL OF LADING--ORIGINAL--NOT NEGOTIABLE. Agents No............

RECEIVED, subject to the classifications and tariffs in effect on the date of issue of this Original Bill of Lading

at 208 Commerce St. May 5, 19 ....., From C. W. KEELAND & CO.,

The property described below, in apparent good order, except as noted (contents and condition of contents of packages unknown), marked, consigned and destined as indicated below, which said Company agrees to carry to its usual place of delivery at said destination, if on its road, otherwise to deliver to another carrier on the route to said destination. It is mutually agreed, as to each carrier of all or any of said property over all or any portion of said route to destination and as to each party at any time interested in all or any of said property, that every service to be performed hereunder shall be subject to all the conditions, whether printed or written, herein contained (including conditions on back hereof), and which are agreed to by the shipper and accepted for himself and his assigns.

The rate of Freight from .... to Pittsburgh is in cents per 100 Lbs

IF .. Times 1st	IF 1st Class	IF 2d Class	IF Rule 25	IF 3d Class	IF Rule 26	IF Rule 28	IF 4th Class	IF 5th Class	IF 6th Class	IF Special per ...	IF Special per ...

(Mail address—Not for purposes of Delivery.)

Consigned to W. H. Ingram 1873 Elm St.

Destination, Pittsburgh State of Penna. County of Allegheny

Route, Your line Car Initial............Car No............

No Packages	Description of Articles and Special Marks	Weight (Sub to Cor.)	Class or Rate	Check Column	If charges are to be prepaid, write or stamp here "To be prepaid."
60	scks. #1 Corn	6082#			
60	" #2 Corn	6114#			Received $ ...... to apply in prepayment of the charges on the property described hereon.
60	" Oats	3849#			
					.... Agent or Cashier.
					Per .... (The signature here acknowledges only the amount prepaid.)
					Charges Advanced
					$ ......

C. W. KEELAND & CO., Shipper, Per B ....Agent, Per............

(This Bill of Lading is to be signed by the shipper and agent of the carrier issuing same.)

First or Original Form of Bill of Lading.

NOTE—That part of illustrations of forms 2 and 3 not shown, is the same as the lower part of the illustration of the first or original form.

Illustration No. 23—Bill of Lading

The Statement of Account

As previously explained, when goods are sold, an invoice or bill showing quantities, prices, etc., is made and sent to the customer. In the case of a wholesale house the terms are stated on each bill and if the bill is not paid on the due date, the customer is reminded of the fact that it is due and is requested to remit. If several bills become due and are unpaid a statement may be made showing the customer the total due, but the practice of sending such statements except in the case of overdue amounts is not prevalent in the wholesale trade.

On the sales ticket made at the time of a retail sale the terms are not stated, for it is understood that the amount is to be paid at the

(*Continued on page 219*)

MONTHLY STATEMENT.

New York, Mar 1 19__

M J. F. Sherwood

Boston, Mass.

TO **O. J. SOMERS & CO.,** DR.

87 NASSAU STREET

Feb	12	To Mdse.	86	75		
	21		10			
	27		27	50	124	25
		Cr.				
Feb	18		50			
	25		10		60	
					64	25

WE SEND STATEMENTS OF ALL ACCOUNTS, DUE OR NOT DUE, FIRST OF EACH MONTH TO GIVE OPPORTUNITY FOR CORRECTION OF ANY ERRORS, AND FOR A REMITTANCE OF THE AMOUNT IF DUE.

Illustration No. 24—Statement of Account

end of the month. In the retail trade it is customary to make a summary of the amount due and mail it to the customer at the end of the month. This has become so prevalent that the customer usually awaits the arrival of this statement, which is called the Statement of Account, before paying the amount due.

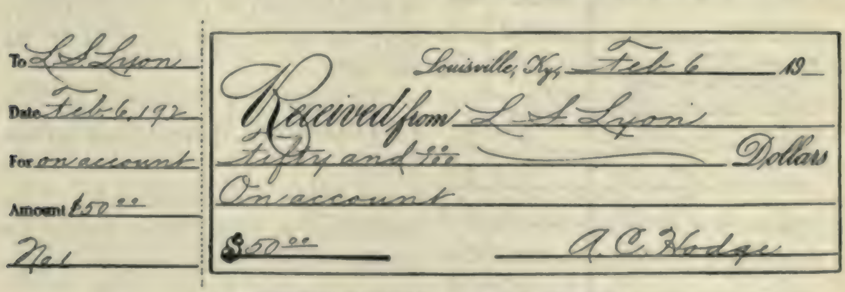
The Receipt

A Receipt is a written acknowledgement from the receiver to the giver of money or other property in payment of some form of indebtedness. Although formerly it was in prevalent use, the receipt is rarely employed in modern business practice. If the creditor renders a bill or statement of account, the payment of the account may be stated on the face of this statement when the payment is made. A bill or statement may be receipted by having written or stamped across its face the following or its equivalent:

Received Payment
October 30, 1919
Chicago Wholesale Grocery Co.
Per——————

At the present time payments are usually made by check, and since the check must be endorsed by the payee, it serves as a receipt.

When formal receipts are used, they are issued from a book in which a stub or duplicate is provided for each receipt. This provides a permanent record of the information given on each receipt. The illustration below shows a receipt and stub properly filled out.


To L. S. Lyon
Date Feb. 6, 192-
For on account
Amount $50.00
No 1

Louisville, Ky., Feb 6 19
Received from L. S. Lyon
Fifty and 00/100 Dollars
On account
$50.00
A. C. Hodge

Illustration No. 25—The Receipt

Forms Used in Connection with Transactions with a Bank

As indicated several times in the previous discussion, it is the practice of business men to place the cash funds with which they carry on the operations of their business in the custody of a bank. They

pay their obligations by giving their creditors a check on their bank. The nature and form of such a check have been discussed and illustrated in the preceding chapter. The customers of the business usually pay their obligations by giving checks on their banks, and in most cases the bank in which the customer has his funds deposited is a different one from the bank where the business has its funds. The business deposits these checks, which means it gives them to its bank and the bank adds them to the amount which the business has on deposit and then collects from the bank on which they are drawn. The forms used in connection with the depositing and withdrawing of money from the bank are:

1. The Deposit Ticket.
2. The Signature Card.
3. The Pass Book.
4. The Bank Statement.
5. The Check Book.

The Deposit Ticket

When a deposit is made, the depositor lists the currency and cash items to be deposited on a printed form provided by the bank, which is known as a Deposit Ticket. It contains the name of the depositor, the date of the deposit, the total amount of bills and specie, and the individual checks to be deposited. A simple form ot the deposit ticket may be as in the illustration at the left.

In making a deposit it is well to follow the instructions given below:

1. If the number of coins to be deposited is large, they should be placed in envelopes or coin wrappers provided by the bank.

2. Paper money should be arranged in order, with the smallest denominations on top.

3. Checks should be arranged in the order in which they are listed on the deposit ticket. The

MERCHANTS NATIONAL BANK

DEPOSITED BY
James Madison
BY Student
Jan 12 19

PLEASE LIST EACH CHECK SEPARATELY

	DOLLARS	CENTS
CURRENCY	100	
SILVER LESS THAN ONE DOLLAR	56	52
CHECKS AS FOLLOWS		
Chicago Ill.	133	40
Denver Colo	93	60
Third Natl.	66	22
State Natl.	110	20
City Natl.	127	86
St Louis Mo.	450	76
Detroit, Mich	17	62
TOTAL $	1156	18

SEE THAT ALL CHECKS ARE ENDORSED

Illustration No. 26
Deposit Ticket

names of the local banks and the addresses of out-of-town banks should be written at the left, on the same line with the amount of the check.

4. Each check should be properly endorsed.

5. The total of the deposit should be entered at the bottom in the space provided.

The Signature Card

At the time the first deposit is made the bank requires the depositor to sign his name on a Signature Card, so that it can later be identified when it appears on the checks which the depositor draws on the bank.

The Pass Book

At the time of the first deposit the bank gives the depositor a book known as a Pass Book, in which a record is made of each deposit. When the depositor presents his deposit and deposit slip to the bank-teller, he should also present his pass book. The teller enters the amount of the deposit in the pass book and this serves as the depositor's record of the transaction. The teller retains the deposit ticket from which the record of the transaction is made in the bank's books. Formerly it was customary for the depositor to leave his pass book at the bank once each month and the amount of his withdrawals, as evidenced by the canceled checks returned, was entered in it and subtracted from his deposits, thus showing his balance in the bank. This practice is fast becoming obsolete at present, the bank giving or sending the customer, instead, a monthly statement which shows the same results. When the plan of balancing the pass book is followed, the checks drawn against the bank since the book was last balanced may be entered on the credit side and the book ruled and the balance brought down in the same manner as in a cash book. In some cases the total of the canceled checks is entered directly beneath the total of the deposits. By subtracting these totals the balance on deposit is obtained.

The Bank Statement

As stated above, most banks do not follow the practice of balancing the depositor's pass book, but furnish him a monthly statement instead. This may be in form similar to that sent by a commercial

firm to its customers, but it shows the amount due the depositor by the bank rather than the contrary as in the case of the statement of account. Sometimes the bank uses what is known as the envelope form of statement, in which case the deposits, withdrawals, and balance are shown on the back of the envelope, and the canceled vouchers are within. The following will serve as an illustration of the bank statement:

Statement of
J. K. Williams
In account with
First National Bank

6 Vouchers Returned

PLEASE EXAMINE AT ONCE { IF NO ERRORS ARE REPORTED WITHIN TEN DAYS THE ACCOUNT WILL BE CONSIDERED CORRECT AND VOUCHERS GENUINE

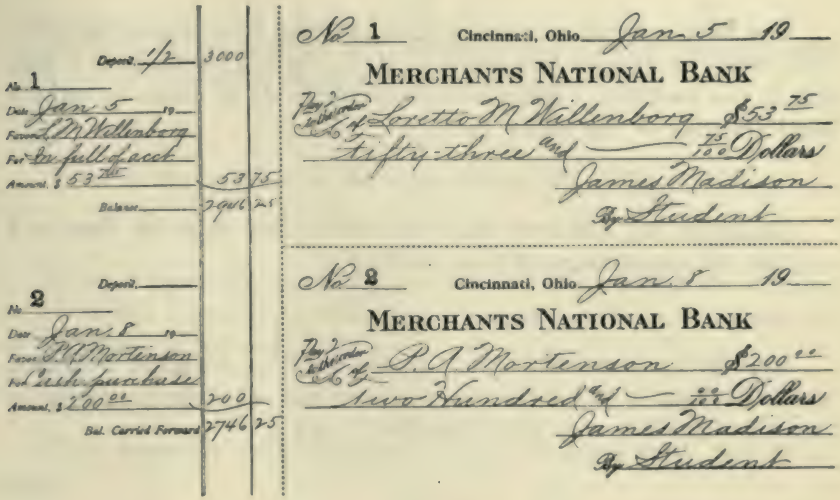
Dec.	1	Deposit	$1,600.00	
	3	Check		$ 36.00
	5	"		142.00
	8	"		178.00
	13	Deposit	486.74	
		Check		162.40
	17	"		187.60
	23	"		162.50
	28	Deposit	278.62	
		Balance		1,496.86

Illustration No. 27—Bank Statement

The Check Book

The purpose and the form of the Bank Check have been discussed and illustrated in the preceding chapter. Checks are usually issued from a bound book which provides for stubs on which is made a record of the checks issued. The stub should always be filled out at the time the check is issued and full particulars given therein. Frequently the check stub serves as a basis for the entry on the credit

side of the cash book and serves as a voucher therefor. Illustration No. 28 shows a check and stub properly filled out.



Deposit 1/2 3000

No. 1

Date Jan 5 19

Favor L. M. Willenborg

For In full of acct

Amount $ 53 75/100 — 53 75

Balance 2946 25

No. 1 Cincinnati, Ohio Jan 5 19

MERCHANTS NATIONAL BANK

Pay to the order of Loretto M. Willenborg $53 75/100

Fifty-three and 75/100 Dollars

James Madison

By Student

Deposit

No. 2

Date Jan 8 19

Favor P. A. Mortenson

For Cash purchase

Amount $ 200 00/100 — 200

Bal. Carried Forward 2746 25

No. 2 Cincinnati, Ohio Jan 8 19

MERCHANTS NATIONAL BANK

Pay to the order of P. A. Mortenson $200 00/100

Two Hundred and 00/100 Dollars

James Madison

By Student

Illustration No. 28—The Check Book

QUESTIONS FOR CLASS DISCUSSION

1

You have a check which you have received from James Simpson. You desire to transfer this check to H. T. Ford in payment of a debt which you owe him. What will you have to do in order to make a legal transfer of the check to Ford?

2

Illustrate the different ways in which this may be done and explain the significance of each method

3

Mr. Ford presents this check to the bank on which it is drawn, and it declines to pay it because Simpson has not sufficient funds on deposit. In what way will this affect you?

4

H. G. Moulton owes you a note for $500.00. He makes a partial payment of $300.00. How would you show this payment on the note?

5

How should a note made by a partnership be signed? If made by a corporation?

6

What is the purpose of the bill of lading? What does it contain?

7

What is the difference between the *straight* and the *order* bill of lading? How many copies of the bill of lading are usually made? What disposition is made of each?

8

What is the purpose of the *statement of account?* Is it used mostly in the wholesale or the retail trade? Why?

What is the purpose of the receipt? Why is it not used as much as formerly?

10

In what way may the check take the place of a receipt?

11

What is the purpose of the *deposit ticket?* Who makes it out? How should the items be arranged on it?

12

What is the purpose of the signature card? When is it signed?

13

What is the purpose of the *pass book?* Who makes the entries in it? What is meant by *balancing* the pass book? Is this practice as prevalent as formerly? Why?

14

What does the *bank statement* show? In what form may it be made?

15

What is the purpose of the check stub? When should it be filled out?

LABORATORY MATERIAL

Practice Set No. 1—Continued

(Continued from Chapter XIV)

Sept. 15. Sold as follows:

G. G. Munn, cash, 100 C @ 75 cents.

N. L. Hasseler, 30 days' account, 200 A @ $1.40.

Enter the cash sale to G. G. Munn in the sales journal and the cash book.

16. Paid clerk hire as follows: Donald Sells, $20.00; Harry Swanson, $18.00.

Received of O. T. Gooch, in payment of invoice of Sept. 6th, $105.00.

17. Sold as follows:

A. M. Chapman, n/20, 400 A @ $1.75; 200 B @ $2.00; 100 C @ 75 cents.

M. B. Reynolds, n/20, 100 A @ $1.25; 200 C @ 75 cents.

18. Purchased as follows:

Ralph House,	n/20,	200 D @ $2.00;	100 E @ $2.50.
John Haywood,	n/10,	100 D @ 1.90;	150 A @ 1.00.
H. L. Cohagen,	n/10,	200 E @ 2.50;	200 A @ 1.00.

19. Erwin C. Cline sent to his home for personal use, 10 A @ $1.00.

Note.—Study this transaction carefully and determine the accounts affected. Inquire of instructor if your intended entry is correct before recording it in the journal. Why is the price in this case stated at $1.00?

20. Issued checks to the following:

John Haywood, $180.00, in payment of invoice of Sept. 10th.

Thomas Hamlet, $120.00, in payment of invoice of Sept. 10th.

Received from John G. Pipken $250.00, in payment of invoice 9/11.

22. Paid Wabash R. R. $90.00, for freight on merchandise received over their road since Sept. 1st. Inquire as to the accounts affected before making record.

23. Paid clerk hire as follows: Donald Sells, $25.00; Harry Swanson, $22.00; A. B. English, $20.00.

24. Paid Ralph House $250.00, in payment of invoice 9/4.

Sept. 24. Paid Rock Island R. R. $60.00, for freight on merchandise received over that road.

26. Sold as follows:

H. L. Orr, cash, 200 A @ $1.20.

D. J. Dwyer, n/10, 300 B @ $2.00; 200 C @ 75 cents.

R. M. Rafferty, n/15, 300 D @ $2.10; 100 E @ $3.00.

27. Mr. Cline gave 20 A @ $1.00 to the Salvation Army. (Charge to Cline's Personal account.)

Gave a 30 days' note for $650.00 to Ralph House, in payment of invoice 9/18.

Paid H. L. Cohagen $700.00, in payment of invoice 9/18.

Paid John Haywood $340.00, in payment of invoice 9/18.

29. Purchased as follows:

Chas. A. Ankromn, n/10, 600 A @ $1.10; 300 B @ $1.50; 400 C @ 50 cents.

Marshall Field & Co., n/15, 80 C @ $1.10; 200 D @ $2.00; 400 E @ $2.50.

30. Paid Bertram Harry $450.00, on account.

Sold P. S. Hackenborn, for cash, 400 A @ $1.25.

Sold I. M. Waugh, n/30, 400 B @ $1.75; 300 C @ 60 cents; 200 E @ $3.00.

Paid clerk hire as follows: Donald Sells, $25.00; Harry Swanson, $22.00; A. B. English, $20.00.

Received 20 days' note for $300.00 from A. R. Manley, in payment of invoice 9/11.

Paid petty expenses, $20.00. (Administrative Expense.)

Instructions: 1. Post from the debit and credit sides of the cash book and the totals of the purchases and sales journals. Open accounts as follows, allowing the space indicated: Cash, 8 lines; Notes Receivable, 5 lines; Furniture and Fixtures, 8 lines; Reserve for Depreciation of Furniture and Fixtures, 5 lines; Notes Payable, 5 lines; E. C. Cline, Proprietor, 8 lines; E. C. Cline, Personal, 5 lines; Merchandise Inventory, 5 lines; Sales, 8 lines; Purchases, 8 lines; Administrative Expenses, 10 lines; Selling Expenses, 8 lines; Profit and Loss, 10 lines.

2. Take a Trial Balance.

Note.—This practice set is continued at the end of Chapter XVI.

CHAPTER XVI

DEPRECIATION

The Necessity for Considering Depreciation

In Chapter III it was stated that the assets of a business may be divided into two classes: those which are in the form of cash or which will be liquidated in cash within a relatively short time in the regular operations of the business, and those which the owner plans to retain in the business and not to liquidate because they are necessary in the conduct of the business. As previously explained, the former are known as *current* assets and the latter as *fixed* assets. In previous chapters, cash, notes receivable, accounts receivable, and merchandise inventory have been given as examples of current assets, and furniture and fixtures and delivery equipment have been given as examples of fixed assets.

Since the fixed assets are retained for use in the business, it should be apparent that such use will cause a continuous decrease in their value. The student will realize readily that such articles as desks, chairs, tables, etc., eventually wear out, no matter how substantial they may be. This decrease in value, which is known in accounting as *depreciation*, takes place during the entire life of the asset. At the end of each fiscal period the depreciation of such assets which has taken place since the beginning of the period must appear on the accounting reports and in the accounts, if the true financial condition of the business is to be shown.

The Nature of Depreciation

The nature of depreciation and its effect on the financial condition of the business may be shown by a simple illustration. If the proprietor of a business purchases a typewriter for $100.00, which will give satisfactory service for ten years, and has a scrap value of $20.00 at the end of that time, the use of the typewriter has cost him $80.00 for the ten years, or $8.00 a year, just as clearly as if he had paid $8.00 a year rent for the use of a machine. This yearly decrease in value of the typewriter, due to its use in the business, must be shown in the accounting records in two ways: it must be shown as a deduction from the asset value of the typewriter, and it

must be shown as an expense of the business. The student should realize that if the typewriter will decrease in value $80.00 in ten years, it would be unwise to wait until the end of the ten years and then show the entire decrease. The Balance Sheets made in the meantime would show the typewriter at its original value of $100.00, which would be clearly erroneous. The yearly decrease in value should also be treated as an expense of conducting the business each year just as a yearly rental of $8.00 would be treated.

Method of Showing Depreciation on the Balance Sheet

The Balance Sheet shows, among other things, the value of the various assets of the business. In order that the Balance Sheet may be of the greatest value to the owner, as well as to others who may be interested in the business, it is necessary that these values be stated as accurately as possible. It is from the Balance Sheet and other such reports that the information which serves as a basis for judging past results and for making future plans is obtained. Judgments and plans based on inaccurate information are dangerous, hence it is especially desirable that the values on the Balance Sheet be stated accurately. The fixed assets of a business are constantly decreasing in value; consequently it is necessary, if their value is to be shown correctly, that the depreciation of each fiscal period be shown on the Balance Sheet prepared at the end of the period.

For purpose of illustration, it may be assumed that J. H. Bishop purchases on January 1st furniture and fixtures costing $500.00 and delivery equipment costing $800.00. If Bishop uses the furniture and fixtures which cost $500.00 at the beginning of the year, it is evident that they are not worth $500.00 at the end of the year. He may not know the exact amount they have decreased in value, but he judges from his own experience and that of others that such furniture and fixtures will be worn out and useless in ten years. Consequently, he estimates that they have decreased in value during the first year one-tenth of their value at the beginning of the year, or $50.00. This estimated decrease in value of the furniture and fixtures may be deducted from the cost, $500.00, and this asset will then be listed on the Balance Sheet at $450.00. Since, however, the $50.00 represents only the estimated decrease in value of the asset, and adjustments may have to be made later, it is thought by accountants and business men to be desirable to show the original cost of the asset

with the decrease in value subtracted therefrom. As previously stated, the decrease in value of an asset, because of its use in the business, is known as depreciation. Therefore the $50.00 allowance for the decrease in value of furniture and fixtures might be termed an "Allowance for Depreciation," but in accounting such estimated decreases in the value of fixed assets are known by the technical term of "Reserves." Hence, the estimated decrease in value of furniture and fixtures is termed "Reserve for Depreciation of Furniture and Fixtures," and the asset will be shown on the Balance Sheet as follows:

Furniture and Fixtures	$500.00	
Less: Reserve for Depreciation of Furniture and Fixtures	50.00	
		$450.00

Delivery equipment decreases in value due to use, the same as furniture and fixtures. Consequently, an allowance for its depreciation should be shown on the Balance Sheet. If Bishop has delivery equipment valued at $800.00 at the beginning of the year, which he estimates will last for five years, he should make an allowance for its depreciation to the amount of $160.00 each year. Accordingly, at the end of the first year he may show his delivery equipment on the Balance Sheet at $640.00, and not show the depreciation as a separate item. The preferable method of showing it, however, is as follows:

Delivery Equipment	$800.00	
Less: Reserve for Depreciation of Delivery Equipment	160.00	
		$640.00

Method of Showing Depreciation in the Accounts

If the original cost of the fixed asset and the amount which it has depreciated are to be shown as separate items on the Balance Sheet, it should be evident that two accounts must be kept with each fixed asset subject to depreciation. For instance, J. H. Bishop must keep two accounts with Furniture and Fixtures and two accounts with Delivery Equipment. The first account in each case will show the original cost of the assets, while the second will show the estimated depreciation to date. The construction of the Furniture and Fixtures account and the Delivery Equipment account

has been explained in Chapter VI. It is now necessary to explain the construction of the Reserve for Depreciation of Furniture and Fixtures account and the Reserve for Depreciation of Delivery Equipment account.

Reserve for Depreciation of Furniture and Fixtures Account

The purpose of the Reserve for Depreciation of Furniture and Fixtures account is to show the net amount of the reserve created to take care of the decrease in value of the property used in the office or store.

The debits and credits to this account are as follows:

Reserve for Depreciation of Furniture and Fixtures

DEBIT:	CREDIT:
With the *cost* price of furniture and fixtures discarded or destroyed. With the difference between the cost and selling price of furniture and fixtures sold.	At the close of the fiscal period with the estimated depreciation of furniture and fixtures during the period.

The balance of this account is shown on the Balance Sheet as a deduction from the original cost of the furniture and fixtures in current use as shown by the Furniture and Fixtures account.

The depreciation of a fixed asset is an expense of the period in which the depreciation occurs; consequently, when the depreciation for the period is credited to the Reserve account some expense account must be debited. The method of making the entry which is necessary to show the depreciation in the accounts is explained under the caption, "Entries Necessary to Record Depreciation."

Reserve for Depreciation of Delivery Equipment Account

The purpose of the Reserve for Depreciation of Delivery Equipment account is to show the net amount of the reserve created to take care of the decrease in value of the property used in the delivery of merchandise to customers.

The debits and credits to this account are as follows:

Reserve for Depreciation of Delivery Equipment

DEBIT:	CREDIT:
With the *cost* price of delivery equipment discarded or destroyed. With the difference between the cost and selling price of delivery equipment sold.	At the close of the fiscal period with the estimated depreciation of delivery equipment during the period.

The balance of this account is shown on the Balance Sheet as a deduction from the cost of the delivery equipment in current use as shown by the Delivery Equipment account. When the depreciation for the period is credited to the Reserve account, some expense account must be debited. The method of making the entry which is necessary to show the depreciation in the accounts is explained below.

Entries Necessary to Record Depreciation at End of the Fiscal Period

Continuing the illustration of the assets of J. H. Bishop, it is estimated that the furniture and fixtures have depreciated in value to the amount of $50.00, hence it is necessary to show this amount as a credit to a Reserve for Depreciation of Furniture and Fixtures account and as a debit to some expense account. Since the furniture and fixtures are used in the administration of the business, the depreciation resulting therefrom may be considered as a charge or debit to Administrative Expenses. Since the delivery equipment is used in connection with the sale of merchandise, the depreciation on it may be treated as a Selling Expense. Accordingly, the estimated depreciation of $160.00 will be debited to the Selling Expenses account and credited to the Reserve for Depreciation of Delivery Equipment account.

The entries for depreciation are a part of the adjusting entries which are made at the end of the fiscal period as explained in Chapter IX. Like the other adjusting entries, they are made in the journal. The entries necessary to record the depreciation in connection with the fixed assets of J. H. Bishop are as follows:

31		
Administrative Expenses	$50.00	
Reserve for Depreciation of Furniture and Fixtures		$50.00
To record the yearly depreciation on furniture and fixtures.		
31		
Selling Expenses	160.00	
Reserve for Depreciation of Delivery Equipment		160.00
To record the yearly depreciation on delivery equipment.		

When these entries are posted, the ledger accounts affected will appear as follows:

Administrative Expenses

192											
Oct	28	For'd from p. 20		2,289	17						
	31			201	10						
Nov.	30			190	78						
Dec.	31			260	00						
	31	Dep. on F. & F.		50	00						

Selling Expenses

192											
Nov.	26	For'd from p. 21		1,410	00						
	30			100	00						
Dec.	31			210	00						
	31	Dep. on Del. E.		160	00						

Reserve for Depreciation of Furniture and Fixtures

						192					
						Dec.	31			50	00

Reserve for Depreciation of Delivery Equipment

						192					
						Dec.	31			160	00

Illustration of Balance Sheet Showing Depreciation on Fixed Assets

In order to illustrate more clearly the method of showing depreciation on fixed assets on the Balance Sheet, the Balance Sheet of J. H. Bishop is given on page 234.

J. H. BISHOP

BALANCE SHEET—December 31, 192..

Assets

CURRENT ASSETS:			
Cash		$1,500.00	
Notes Receivable		100.00	
Accounts Receivable		3,000.00	
Merchandise Inventory		3,500.00	
Total Current Assets			$8,100.00
FIXED ASSETS:			
Furniture and Fixtures	$500.00		
Less: Reserve for Depreciation	50.00		
		450.00	
Delivery Equipment	800.00		
Less: Reserve for Depreciation	160.00		
		640.00	
Total Fixed Assets			1,090.00
Total Assets			9,190.00

Liabilities

CURRENT LIABILITIES:		
Notes Payable	200.00	
Accounts Payable	1,300.00	
Total Current Liabilities		1,500.00
Net Worth or Proprietorship		$7,690.00

Summary

The chief problem in connection with the accounting for fixed assets is the proper recording of the depreciation which arises from their use in the business. With few exceptions, this depreciation is continually going on in connection with all fixed assets, and it is emphasized at this point so that the student will see from the beginning of his study of accounting that no accurate or trustworthy reports can be made with reference to the financial condition of a business unless the depreciation on its fixed assets is taken into consideration.

QUESTIONS FOR CLASS DISCUSSION

1

On January 1st, A. M. Johnson purchases delivery equipment to the amount of $1,200.00. On December 31st, should this asset be shown on the Balance Sheet at cost? If not, how would you determine the amount at which it should be shown?

2

If it is estimated that the delivery equipment has depreciated $115.00 during the year, how would this depreciation be shown on the Balance Sheet?

3

How would the depreciation on the delivery equipment be shown on the Statement of Profit and Loss?

4

If the furniture and fixtures owned by Mr. Johnson have depreciated $50.00 during the year, how should this be shown on the Balance Sheet and the Statement of Profit and Loss?

H. B. Grimes purchases office furniture on June 30, 1919, for $500.00, which he estimates will last for ten years and have a scrap value of $50.00. Explain the effect of this estimate on the Balance Sheet and the Statement of Profit and Loss of Grimes on December 31, 1919.

6

What entries will be necessary on December 31, 1919, in order to give effect to the estimated depreciation on office furniture?

7

Where will these entries be made and what are they called?

8

A. B. King purchases a used automobile for $500.00 to be used for delivering. One month later he sells it for $400.00. Both transactions are for cash. Explain the entries which would be necessary to record these two transactions.

9

On January 1st, D. A. Jones purchases for cash, delivery equipment which costs $700.00. At the end of the year he estimates that this equipment has depreciated $120.00. In order to record this depreciation he makes the following entry:

Profit and Loss	$120.00	
Delivery Equipment		$120.00

Is this entry correct? Why? If not, what entry should he make?

10

Immediately after closing his books, Jones sells his delivery equipment for $580.00. How would this transaction be recorded?

LABORATORY MATERIAL

Practice Set No. 1—Continued

September 30

Instructions: 1. Prepare a Balance Sheet and a Statement of Profit and Loss for Erwin C. Cline from the Trial Balance prepared at the close of Chapter XV, page 227, taking into consideration the following facts:

Inventory of merchandise, $1,200.00.
Depreciation on furniture and fixtures, 2% of cost.

2. Make the adjusting and journal entries.
3. Post these entries and rule the accounts that balance.

CHAPTER XVII

THE ACCOUNTING PROCESS—A SUMMARY

Purpose of This Chapter

In the preceding chapters an attempt has been made to give a simple but comprehensive survey of the process by which business data is recorded, classified, and presented so that it may be used by the business executive and his assistants in the management and control of a business enterprise. It has been necessary, in order to illustrate the principles involved and to show their application, to introduce much extraneous material and considerable detail. It is deemed advisable, therefore, to present at the conclusion of the discussion of this process a brief review and summary so the student may be able to see clearly the relationship between the various subjects discussed.

Accounting Reports

It has been emphasized in the preceding discussion that the primary function of accounting is to provide information which can be used in the management and control of the business enterprise. Since the control of a business is vested in the owner of the business or those to whom he has delegated his authority, it is obvious that this information must be provided in a form in which he can understand and use it. Unfortunately the majority of business executives do not understand much about accounting, so the data provided by the accounting records should be reported to them by means of reports which are accurate and comprehensive but simple and informal in nature. The accountant should always remember that his function is to provide the information which the business executive needs in the management of his business and that the accounting record must be devised to give this information. It should be readily apparent to the student that in different lines of business with different types of organization the information needed as a basis of management will be different and the accounting records required to obtain this information will vary accordingly. For instance, the information needed in order to manage properly a small retail store will be distinctly different from that required in

the management of a large manufacturing business. In each case, however, the owner or manager will desire certain information with reference to the business and will desire this made in the form of a report. In the case of the small retail store, the owner may make the report himself and it may be very informal and incomplete, while in the case of the large manufacturing firm a much more complete and formal report may be made; but in each case reports will be made and the nature and amount of information desired on them will determine in the main the nature of the accounting records kept.

The student will find in the continuance of his study of accounting that an almost indefinite number of reports may be made in connection with a large business. However, in connection with every business the two reports almost invariably made are:

1. The Balance Sheet, which gives the amount and nature of the assets, liabilities, and proprietorship of the business.

2. The Statement of Profit and Loss, which gives the amount and nature of the income and expenses of the business for a certain period and the difference between the two, or its net profit or net loss.

These two reports have been taken in the preceding chapters as a means of illustrating the function of reports and their relation to the remainder of the accounting process, because they are the two in most prevalent use and illustrate the relation of the reports to the whole process better than do any others. If the student understands these reports he should have no difficulty in understanding other reports which he may be called upon to study or use.

The Accounts

The information which appears on the accounting reports is obtained from the record of business data kept in the accounts. The number and nature of the accounts are determined, of course, by the nature of the information desired on the reports. For each item of information appearing on the reports there should be kept an account, except, of course, with such items like "gross profit on sales," which are obtained by a combination of other items. Accounts are constructed so that the effect of any transaction on the financial condition of the business can be reflected in them. The title of the account should be such as to indicate clearly the nature of the information recorded in it. Since the information provided by the ac-

count will appear on the reports under the account title, the title should be such as will be readily understood by those who are to use the reports. Since the primary purpose of the accounts is to provide the information appearing on the reports, no attempt should be made to devise a system of accounts for a business until the nature of the reports desired by the management is determined. For this reason the accounting reports have been studied first in the preceding discussion.

The Books of Original Entry

The transactions of a business are not recorded directly in the accounts, a preliminary record being made in certain records, frequently called Books of Original Entry, from whence they are posted or transferred to the ledger accounts. The number and nature of the books of original entry used are dependent upon the amount and nature of the information desired with reference to the business. The purpose of each book of original entry is to provide a summary of transactions of like kind. When transactions of any kind become of frequent occurrence a special journal will be provided for their record. All transactions which can not be recorded in any special journal are recorded in the general journal. The transactions of most frequent occurrence in a mercantile business are those with cash received, cash paid, merchandise sold, and merchandise purchased. Accordingly, in the preceding discussion the purchases journal, the sales journal, and the cash book, have been given as illustrations of the special journals. The student should bear in mind that all books of original entry are journals, and that the debits and credits posted from each of them must be equal. Each transaction should be analyzed and its effect on the financial condition as reflected in the accounts and later on the reports should be determined before it is recorded in the books of original entry.

Business Vouchers and Forms

The information necessary to make a record in the books of original entry is obtained from the Business Vouchers which serve as evidence of the transactions. These business vouchers serve not only as a basis of the entries made in the journals, but also many of them are used as a means of facilitating the transactions of which they bear evidence. There are also business forms which serve the latter purpose and not the former. There are some business papers which have certain characteristics not common to business papers in general, and these are known in both law and accounting as nego-

tiable instruments. There are some business forms which arise and are used only in connection with the purchase and sale of merchandise. A classification of business forms may therefore be as follows:

1. Vouchers Used in Connection with Merchandise Purchases and Sales.
2. Negotiable Vouchers.
3. Miscellaneous Vouchers and Forms.

Each of these classes has been explained and illustrated in the preceding chapters, and further discussion is unnecessary here.

The Accounting Process

From the above discussion it may be seen that the accounting process involved from the time the transaction is performed until its effect on the business is shown on the accounting reports may be represented in outline as follows:

Transactions—Vouchers—Books of Original Entry—Accounts—Reports.

The transactions performed by the business are evidenced by the various vouchers previously discussed. From these vouchers the transactions are entered in the books of original entry or journals, each journal except the general journal providing a summary of transactions of like kind. The entries are posted from these journals, and from the accounts the reports are made. This is the accounting process which is followed in every business of every type which has an accounting system, although in some it is not so well developed as in others. Obviously, in some businesses the form of vouchers, as well as the form and name of the journals and the titles of the accounts, will be different from those given in the preceding chapters by way of illustration. The principles governing their construction and use and their relation to each other will be, with few exceptions, the same as given in the preceding discussion.

It is obvious to the reader that in this text the discussion has not followed the order indicated in the above graph, but rather the reverse. The order followed in the preceding discussion may be shown by the following:

Reports — Accounts — Books of Original Entry — Vouchers — Transactions.

The latter order has been followed because in the main the nature of the information on the reports determines the number and

nature of the accounts; the information desired in the accounts determines largely the nature of the books of original entry, and in turn the information recorded in the latter determines to a considerable degree the information which appears on the vouchers. The procedure followed was chosen because by this method in the study of each part of the accounting process the factors which determine its nature can be seen and understood.

Importance of the Accounting Process

It is imposible for the student to learn in school, or even outside of school, all the special forms of records used by different business firms. Even if it were possible, it would not be desirable, because a knowledge of the detailed records of various businesses would be of no value to him. If he understands the nature of the accounting process and the function of the various parts of the process as explained in the previous chapters, and as further explained in future chapters, he will have little difficulty in understanding the special forms and records used by any particular business. If, as is very probable, he does not work in the accounting department of the business, but in some of the other various departments, he will be able to interpret and understand the reports he may have to use or the records which may be used by his department and the relation of these records and reports to the accounting process as a whole. A thorough knowledge of the accounting process is, therefore, of prime importance

QUESTIONS FOR CLASS DISCUSSION

1

What is the purpose of a *report?*

2

What are the two reports which are most frequently used by business men?

3

What information does the Balance Sheet contain?

4

How are the assets of a business classified on the Balance Sheet? Explain the difference between the two classes and give four illustrations of each kind.

5

What are the liabilities which are of most frequent occurrence in a retail business?

6

What information does the Statement of Profit and Loss contain?

7

What items are necessary to ascertain the cost of goods sold?

8

How is the value of the inventory which appears on the Balance Sheet and the Statement of Profit and Loss determined?

9

What are *operating* expenses? Give two illustrations of such expenses.

10

What determines the number and nature of the accounts kept by a business?

11

What principle is it necessary to remember in the debiting and crediting of accounts with fixed assets?

12

Describe how an account may be transferred from one page to another.

13

What is meant by the *balance* of an account? When an account is in balance, how is this indicated?

14

How are personal accounts ruled?

15

Why are entries first made in books of original entry instead of being entered directly in the accounts?

16

Name four books of original entry, the purpose of each, and how each is posted.

17

What is the purpose of the Trial Balance, and how often is it taken?

18

What is the purpose of the *adjusting* entries? Give the adjusting entries which have been made in the preceding work.

19

What is the purpose of the closing entries? Give the entries necessary to close the Purchases, Sales, Administrative Expenses, Selling Expenses, and Profit and Loss accounts.

20

What is the purpose of the voucher? How may vouchers be classified?

21

Give the name and purpose of five negotiable instruments.

22

What are the requisites of a negotiable instrument? Illustrate each.

23

Explain how a deposit is made at the bank. What forms are necessary in carrying on transactions with the bank?

24

What is meant by the "accounting process"? Is this process the same in all businesses?

25

Why is an understanding of the accounting process important?

LABORATORY MATERIAL

Practice Set No. 2, Chapter XVIII, should be completed next.

CHAPTER XVIII

THE APPLICATION OF PRINCIPLES—A PRACTICE SET

Purpose of Chapter

The purpose of this chapter is to provide material which will illustrate and require the application of the principles discussed in the preceding chapters. The work is designed to illustrate the entire accounting process. Whether the business vouchers are used is optional with the instructor. If desired, the record can be made from the memoranda of transactions which follow, without reference to the business vouchers which in practice would serve as evidence of these transactions. If preferred, the material of this chapter can be obtained in the form of a business practice set which is published separately. If the latter material is used, the transactions in the text will be useful by way of review and as a manual of reference while the work is being performed.

Preliminary Instructions

The transactions given in the chapter represent certain transactions of a retail clothing merchant. No attempt is made to give all the transactions which would be performed in a period of the length covered by the exercise, but only to give such transactions as are indicative of those performed by such a retail business. Although the transactions given deal with the commodities purchased and sold by a retail clothing store, they are intended to illustrate the general principles of accounting rather than the technique of the accounting system of any particular business. In other words, it is the purpose of this exercise to illustrate *principles* rather than the *practices* of any particular business.

The preliminary record of the transactions is to be made in the following books of original entry: journal, cash book, sales journal, and purchases journal. The exercise covers a period of two months. A Trial Balance is to be taken at the end of the first month. At the end of the second month a Trial Balance, a Balance Sheet, and a Statement of Profit and Loss are made, and the ledger closed. Very few instructions are given with reference to the individual transactions. It is assumed that if the student has satisfactorily completed the preceding work, he will be able to perform the work required by this exercise without detailed instructions.

Practice Set No. 2

MEMORANDA OF TRANSACTIONS

RETAIL CLOTHING BUSINESS

L. C. JOHNSON

NOVEMBER TRANSACTIONS

1. L. C. Johnson invests $3,000.00 in the retail clothing business. He employs you as bookkeeper at a salary of $65.00 per month.

2. Bought of Alfred, Decker & Cohen, on account, merchandise per invoice of this date: 10 suits at $25.00; 5 suits at $30.00; 2 suits at $37.50; total, $475.00.

   Use the date of the transaction as the date of the invoice and the name of the city in which your school is located as the address of the purchaser. Number the invoices consecutively, beginning with one.

   Paid $40.00 rent for month.

3. Bought of Phillips Bros., on account, merchandise per invoice of this date: 10 overcoats at $30.00; 2 suits at $17.50; total, $335.00.

4. Bought of Cluett, Peabody & Co., on account, merchandise per invoice of this date: 5 dozen shirts at $15.00; 5 dozen shirts at $18.00; 2 dozen shirts at $24.00; 20 dozen collars at $2.00; 10 dozen collars at $3.00; total, $283.00.

5. Sold R. P. Douglas, on account, merchandise: 1 suit at $55.00; 3 shirts at $3.00; 4 collars at 25c; total, $65.00.

   Use the name of the city in which your school is located as the address in this and succeeding sales. Number the sales consecutively beginning with one.

6. Bought of National Store Equipment Co., for cash, 4 wall cases at $150.00; 3 show cases at $50.00; 1 clothing rack at $25.00; total, $775.00.

   Received $70.00 for sundry cash sales to date.

8. Sold M. Cross, on account, merchandise: 3 shirts at $3.00; 5 collars at 40c; 1 shirt at $2.00; total, $13.00.

   Bought of Standard Necktie Co., on account, merchandise per invoice of this date: 4 dozen neckties at $6.00; 2 dozen neckties at $9.00; 3 dozen neckties at $12.00; 4 dozen suspenders at $4.50; total, $96.00.

9. Bought of Rothschild Clothing Co., on account, merchandise per invoice of this date: 15 suits at $14.00; 10 suits at $24.00; 4 overcoats at $20.00; total, $530.00.

   Received $20.00 from R. P. Douglas to apply on account.

10. Sold C. Jasper, on account, merchandise: 1 suit at $40.00; 2 ties at $1.50; 2 pairs suspenders at 50c; 1 shirt at $2.50; 1 shirt at $3.00; total, $49.50.
   Bought from Alfred, Decker & Cohen, on account, merchandise per invoice of this date: 10 overcoats at $30.00; 10 suits at $30.00; 2 suits at $25.00; 2 dozen pairs trousers at $84.00; 1 dozen pair trousers at $72.00; total, $890.00.
11. Paid $25.00 for newspaper advertising.
12. Sold S. Newton, on account, merchandise: 1 suit at $35.00; 2 pairs trousers at $10.00; 2 shirts at $2.50; total, $60.00.
13. Received $155.00 for sundry cash sales to date.
   Paid Alfred, Decker & Cohen $475.00 in full for invoice of November 2nd.
15. Sold R. P. Douglas, on account, merchandise: 1 suit at $25.00.
   Paid Cluett, Peabody & Co. $100.00 on account.
16. Bought of Standard Necktie Co., on account, merchandise as per invoice of this date: 2 dozen mufflers at $12.00; 2 dozen ties at $5.50; total, $35.00.
17. Bought of Goodyear Rubber Co., on account, 10 cravenettes at $20.00; 10 cravenettes at $15.00; 5 cravenettes at $17.00; total, $435.00.
18. Received $70.00 from R. P. Douglas in full of account.
19. Sold G. Jerome, on account, merchandise: 1 overcoat at $35.00; 1 pair trousers at $10.00; total, $45.00.
20. Paid Phillips Bros. $150.00 on account.
   Received $210.00 for sundry cash sales to date.
22. Sold Doval Logging Co., on account, merchandise: 8 suits at $20.00; 6 pairs trousers at $9.00; 3 shirts at $3.00; 1 shirt at $2.00; total, $225.00.
23. Bought of the Michigan Woolen Co., on account, merchandise per invoice of this date: 10 mackinaws at $10.00; 5 mackinaws at $12.00; 1 dozen shirts at $48.00; 1 dozen shirts at $36.00; 4 dozen sox at $4.50; 6 dozen sox at $6.00; 6 dozen sox at $7.00; 2 dozen sox at $9.00; total, $358.00.
24. Received $13.00 from M. Cross in full of account.
   Paid Rothschild Clothing Co. $150.00 to apply on account.
25. Received $25.00 from C. Jasper to apply on account.
26. Sold Doval Logging Co., on account, merchandise: 2 mackinaws at $15.00; 4 shirts at $5.00; total, $50.00.
27. Paid $25.00 for billboard advertising.
   Received $225.00 for sundry cash sales to date.

29. Paid $38.00 for freight and drayage.
    Received $100.00 from Doval Logging Co. to apply on account.
30. Paid Standard Necktie Co. $50.00 to apply on account.
    Paid bookkeeper's salary, $65.00.

Instructions: 1. Post all the entries in the books of original entry, including the totals.

2. In opening the accounts allow ten lines for each.

3. Take a Trial Balance.

4. After the Trial Balance is approved by the instructor, proceed with the December transactions.

DECEMBER TRANSACTIONS

1. Sold R. P. Douglas, on account, merchandise: 1 suit at $28.00.
   Paid rent for month, $40.00.
2. Bought of Cluett, Peabody & Co., on account, merchandise per invoice of this date: 5 dozen shirts at $18.00; 1 dozen shirts at $24.00; 1 dozen shirts at $30.00; 2 dozen collars at $2.00; total, $148.00.
3. Received from Doval Logging Co. their 60-day note for $175.00 in full of account.
   Received $185.00 for sundry cash sales to date.
4. Sent Alfred, Decker & Cohen a check for $500.00 to apply on account.
6. Sold M. Cross, on account, merchandise: 1 cravenette at $25.00; 1 shirt at $2.50; total, $27.50.
7. Sent Phillips Bros. a check for $185.00 in full of account.
8. Received $24.50 from C. Jasper in full of account.
   Bought from Alfred, Decker & Cohen, on account, merchandise per invoice of this date: 12 suits at $25.00; 6 suits at $30.00; 4 suits at $35.00; 10 spring overcoats at $20.00; 5 spring overcoats at $22.50; 5 pairs trousers at $6.50; total, $965.00.
9. Sent Cluett, Peabody & Co. a check for $183.00 in full for invoice received November 4th.
   Sold P. Miller, on account, merchandise: 1 suit at $30.00.
   Sold L. Cramer, on account, merchandise: 1 cravenette at $30.00; 1 shirt at $4.00; total, $34.00.
10. Paid for newspaper advertising, $35.00.
    Received $228.00 for sundry cash sales to date.
    Sold O. T. Watson, on account, merchandise: 1 spring overcoat at $35.00; 1 shirt at $4.00; total, $39.00.

11. Sent Rothschild Clothing Co. a check for $380.00 in full of account.
    Sold C. McGraw, on account, merchandise: 2 shirts at $4.00; 1 pair trousers at $10.00; 2 neckties at $1.50; total, $21.00.
13. Paid Goodyear Rubber Co. $200.00 to apply on account.
    Sold G. Monroe, on account, merchandise: 1 suit at $45.00.
14. Mr. Johnson invests cash, $200.00.
    Bought of Keith Bros. merchandise on account per invoice of this date: 10 dozen hats at $30.00; 2 dozen hats at $36.00; 1 dozen hats at $48.00; total, $420.00.
    Sold D. Norton, on account, merchandise: 1 hat at $5.00; 1 spring overcoat, $30.00; total, $35.00.
15. Bought a safe for cash, $100.00.
16. Paid Michigan Woolen Co., to apply on account, $200.00.
    Sold to Peter Stanley, on account, merchandise: 1 top overcoat at $30.00; 1 shirt at $4.00; 1 pair trousers at $9.00; 1 hat at $5.00; 1 tie at $1.50; total, $49.50.
17. Sold to C. Jasper, merchandise: 1 hat at $7.00; 2 shirts at $3.00; 1 shirt at $4.00; 1 pair trousers at $10.00; 2 pairs suspenders at 75c; 1 tie at $1.50; total, $30.00.
    Received $250.00 for sundry cash sales to date.
18. Received $35.00 cash from S. Newton to apply on account.
20. Paid Standard Necktie Co. in full of account.
21. Gave National Store Equipment Co. a 60-day note for $100.00 in payment for a show case received today.
22. Bought of Cluett, Peabody & Co., on account, merchandise: 2 dozen shirts at $24.00; 7 dozen collars at $2.00; 1 dozen collars at $3.00; total, $65.00.
23. Paid for freight and drayage, $12.50.
    Paid for advertising, $25.00.
24. Received from G. Jerome his 30-day note for $25.00 to apply on account.
    Received $190.00 for sundry cash sales to date.
    Paid Goodyear Rubber Co. $235.00 in full of account to date.
27. Paid Keith Bros. $250.00 to apply on account.
28. Bought from Standard Necktie Co., on account, merchandise per invoice of this date: 5 dozen neckties at $12.00; 2 dozen suspenders at $7.50; total, $75.00.
29. Bought cash register for cash, $150.00
30. Sold Doval Logging Co., on account, merchandise: 10 shirts at $7.50; total, $75.00.

31. Paid bookkeeper's salary for month, $65.00.
    Stamps and stationery, $5.50.

Instructions: 1. Post all entries in books of original entry, including the totals, and take a Trial Balance.

2. Make a Balance Sheet and a Statement of Profit and Loss, taking in consideration the following:

   (a) Merchandise inventory, $3,650.00.

   (b) Depreciation on furniture and fixtures, $20.00.

3. Make the adjusting and closing entries.

4. Post these entries and rule the accounts that balance.

CHAPTER XIX

PROPRIETORSHIP

The Partnership

In the preceding chapters emphasis has been placed upon the fact that the primary function of accounting is to provide information with reference to a business which may be used in its management and control. The function of business management is to increase the proprietorship of the business, and accounting, therefore, must provide information which will make such an increase possible. The proprietorship may be vested in an individual who is known as the sole proprietor, or it may be vested in two or more individuals who have made an agreement to combine their property and labor in certain proportions and to share the increase or decrease of proprietorship which results from the operations of the business, in which case there exists what is known as a *partnership.*

Many definitions of partnership have been given, but the following one by Chancellor Kent is quite descriptive:

> "A contract of two or more competent persons to place their money, effects, labor, and skill, or some or all of them, in lawful commerce and business, and to divide the profits and bear the losses in certain proportions."

It is necessary to see the nature and characteristics of a partnership so as to be able to understand what information the accounting records must provide in order that such a form of proprietorship may properly manage and control the business.

Essential Characteristics of a Partnership

In a partnership each partner is the agent of the other partners in the operation of the business. That is, one partner can make an agreement to purchase goods and services for the business and the

other partners are bound by his act if the goods and services are such as the business uses or might use. They are bound and must pay for the goods and services even though they have not authorized him to purchase them. So it is with other agreements entered into by one partner on behalf of the partnership—the act of one partner is the act of each of the other partners, each partner being an agent of the firm for the purpose of the business of the partnership.

Another characteristic of the partnership is its limited life. The death, incapacity, or withdrawal of one of the partners causes a dissolution of the partnership. If a partner sells his interest in the business, this causes a termination of the partnership. If the remaining members admit the new member, a new partnership exists. A partnership can not be perpetual, and since its life may be short its business policies may be affected thereby. This in turn affects the nature of the information desired from the accounting records.

Each member of a partnership is jointly and individually liable for the debts of the firm. As a result, a member of a partnership may lose not only what he has invested in the partnership, but may also be required to use property not invested in the partnership in the payment of its debts, if it becomes insolvent. For instance, if Jones and Smith each invest $3,000.00 in a partnership, and through ill-luck or poor management it happens later that the partnership has liabilities of $6,000.00 and assets of only $5,000.00, the creditors may recover the $1,000.00 excess of liabilities over assets from either Jones or Smith individually. It can be readily seen, therefore, since each partner is free to represent the firm as an agent and the partners may be liable individually for the debts of the firm, that an ill-chosen partner may bring financial difficulties to the other members of the firm. It is also apparent that accurate accounting records which will at all times show the status as well as the tendency of the financial condition of the firm are essential.

Another feature essential to a partnership is the co-ownership of the profits of the business. If the profits are shared on any basis other than co-ownership a partnership does not exist. For instance, an employee may be given a percentage of the profits as a remuneration for his services, but this does not constitute a partnership. If it is the intention of the parties that co-ownership of profits shall exist, the agreement between them will be construed as constituting a partnership.

In view of the above discussion, the essential characteristics of a partnership may be stated in summary form as follows:

1. Mutual agency—each partner is the agent of the other partners, and they are bound by his acts.
2. Limited life—the partnership can not be perpetual and is dissolved as the result of a variety of causes, some of which are apt to occur at any time.
3. Liability of individual members for partnership debts.
4. Co-ownership of partnership profits.

Relation of Partnership to Accounting

In the main the accounting for a partnership is the same as for a business with any other form of ownership. The current transactions relating to the general operations of the business are the same and the accounting process, as well as the forms, records and reports employed, are essentially the same. However, the legal relationship existing between the members of a partnership as discussed above gives rise to certain transactions which are not common to the sole proprietorship, and it is necessary to notice briefly their effect on the accounting records and business practice and routine. The relation of the partnership to accounting may be discussed under the following heads:

1. The formation of a partnership.
2. The operation of a partnership.
3. The dissolution of a partnership.

The Formation of a Partnership

As between the parties themselves, a partnership is founded upon a voluntary contract which must have all the essential elements of any other contract. What these essentials are can be determined by consulting a text on commercial law. Since this discussion is interested primarily in the partnership from the viewpoint of accounting, it is not deemed advisable to explain the various legal questions involved. Because of the somewhat peculiar relationship existing between the partners, involving mutual agency and unlimited liability of individual members for partnership debts as well as the limited life of the partnership, disputes, misunderstandings, and difficult situations are apt to arise. In order to

avoid these, or at least to reduce them to a minimum, it is desirable to have a written contract which will provide stipulations covering the points about which misunderstandings might arise. Such a contract is known as the "Articles of Copartnership," and should contain the following stipulations with such additional provisions as may be applicable to a particular undertaking:

1. Date.
2. Names of the partners.
3. Statement that they are to be partners.
4. Nature of the business or undertaking.
5. Duration of the relation.
6. Name of the firm and its location.
7. Amount of the capital and each partner's investment.
8. Payment of expenses.
9. Distribution of profits and sharing of losses.
10. Rights of partners to withdraw money for personal use.
11. Keeping of books of account.
12. Duties of the several partners.
13. Restraint upon partners as to becoming sureties, etc.
14. Special provisions and stipulations.
15. Proper provisions for dissolution.
16. Division of assets after dissolution.

An agreement embodying these stipulations may be in some such form as the following:

ARTICLES OF COPARTNERSHIP

This contract made and entered into this the 2nd day of July, 1920, by and between E. C. Cline, of Little Rock, Ark., of the first part, and J. G. Pipkin, of the same city and state, of the second part;

Witnesseth: That the said parties have this day formed a copartnership for the purpose of engaging in and conducting a retail wood, coal and ice business under the following stipulations which are made a part of this contract:

1. The said copartnership is to continue for a term of five years from date hereof, unless dissolved by mutual agreement.

2. The business shall be conducted under the firm name of E. C. Cline & Co., and its place of business, unless changed by permission of both partners, shall be at 212 South Main street, Little Rock, Ark.

3. The investments are as follows: E. C. Cline, $2,000.00; J. G. Pipkin, $2,000.00.

4. All profits or losses arising from said business are to be shared as follows: E. C. Cline, one-half; J. G. Pipkin, one-half.

5. Complete books of account are to be kept and a Balance Sheet and a Statement of Profit and Loss are to be prepared annually.

6. Each partner is to devote his entire time and attention to the business and is not to engage in any other enterprise without the written consent of the other.

7. Each partner is to have a salary of $100.00 per month, the same to be withdrawn at such time or times as he may elect. Neither partner is to withdraw from the business an amount in excess of his salary without the written consent of the other.

8. E. C. Cline is to have general supervision of the business, place all orders for merchandise, have charge of the accounting records, and sign all business papers or authorize the bookkeeper to sign them. J. G. Pipkin is to have supervision of incoming merchandise and the merchandise stock. In addition to the duties outlined, each partner is to attend to such other duties as shall be deemed necessary for the successful operation of the business.

9. Neither party is to become surety or bondsman for any one without the written consent of the other.

10. In case of the death, incapacity, or withdrawal of either partner, the business is to be conducted for the remainder of the fiscal year by the surviving partner, the profits for the year allocated to the withdrawing partner to be determined by the ratio of the time he was a partner during the year to the whole year.

11. In case of dissolution the assets are to be divided in the ratio of the capital invested at the time of dissolution.

In witness whereof, the parties aforesaid have hereunto set their hands on the day and year above written.

E. C. CLINE,
J. G. PIPKIN.

After the partnership contract has been made and the articles of copartnership prepared, it is necessary to open the books of the new firm. In the main the opening entries for a partnership are the same as for a sole proprietorship except that the two or more accounts of the partners are credited with the proprietorship instead of the one account of the sole proprietor. If the partners invest only cash the opening entries may be made in the cash book. If other property is invested a journal entry is necessary. If any of the partners have liabilities which the new business assumes, it is necessary to enter them in the journal and to credit proprietorship for the difference between the assets invested and the liabilities assumed.

To illustrate the making of such entries, it may be assumed that W. C. Chamberlain and C. F. Allen, who are conducting rival retail dry goods stores, enter into a partnership and consolidate the two stores.

The assets and liabilities of W. C. Chamberlain are as follows: cash, \$500.00; accounts receivable, \$2,500.00; merchandise inventory, \$2,000.00; office and store equipment, \$1,200.00; accounts payable, \$1,000.00; notes payable, \$500.00. The assets and liabilities of C. F. Allen are as follows: cash, \$750.00; accounts receivable, \$2,250.00; notes receivable, \$200.00; merchandise inventory, \$2,800.00; office equipment, \$400.00; building, \$1,500.00; land, \$1,100.00; accounts payable, \$2,000.00.

The journal entry for recording the above assets and liabilities, as well as the proprietorship of the two partners, would be as follows:

Cash	\$1,250.00	
Notes Receivable	200.00	
Accounts Receivable	4,750.00	
Merchandise Inventory	4,800.00	
Office Equipment	1,600.00	
Building	1,500.00	
Land	1,100.00	
Notes Payable		\$ 500.00
Accounts Payable		3,000.00
W. C. Chamberlain, Prop. .		4,700.00
C. T. Allen, Prop.		7,000.00

The Operation of a Partnership

The only transactions performed by a partnership during the period of operation, which are different from the transactions performed by the sole proprietorship, are those between the partnership and the members thereof. It is necessary to discuss the most frequent transactions between the partnership and its members.

It is frequently stipulated in the articles of copartnership that the partners are to receive a certain compensation for their services. When this agreement exists it is customary to record the amount of the salary of each partner at the end of each month, whether or not it is withdrawn by him. It is customary to keep two accounts with each partner, one being his Investment or Capital account and the other his Personal account. These accounts serve the same function as the same two accounts of the sole proprietor as discussed in Chapter VI. The salary paid to a partner is an operating expense of the business the same as if it had been paid to any other employee. Consequently, at the end of the month some Expense account, usually Administrative Expenses, depending of course upon the duties performed by the partner, is debited for the amount of his salary, and his Personal account is credited. His withdrawals are debited to his Personal account, and the balance of this account, if a credit, shows the amount the business owes the partner, while if a debit, it shows the amount which he owes the business. Frequently there are provisions in the partnership contract which prohibit the partner from withdrawing an amount in excess of a certain sum. It may be well to add that partners are not entitled to salaries unless there is an explicit agreement to that effect.

The partnership, like all other forms of business enterprise, is organized for profit, and since there is a co-ownership of profits on the part of the partners, it is necessary at the end of the fiscal period to determine not only the amount of the profits earned by the business, but also the amount to be allocated to each partner. Many difficult questions arise in connection with the distribution of the partnership profits, and in order to eliminate as much difficulty as possible the partnership agreement should be quite specific as to how the profits are to be divided. If the partnership agreement is silent, the law provides that the profits shall be divided equally among the partners, regardless of the amounts of their respective investments of capital. Some of the partners may have

invested little, if any, capital, but they will share equally in the profits unless it is otherwise specified. If the partnership agreement does not provide as to the division of the losses the profit-sharing ratio governs. If the agreement does not provide for the disposition of the profits then the losses will be borne equally.

At the end of the fiscal period, when the summary of the income and expenses is made in the Profit and Loss account, the balance of the account will show the net profit of the business for the period. After each partner's share of this net profit is determined the Profit and Loss account is debited and the partner's Capital account credited for the amount. When the entries for each partner's share of the profits have been made the total net profit will have been distributed and the Profit and Loss account will balance. In case of a net loss the reverse of the above procedure is followed, the Profit and Loss account being credited and each partner's Capital account debited for his share of the loss.

The Dissolution of a Partnership

As previously explained, a partnership can not be of permanent duration, and as a consequence a dissolution of a partnership may be necessary. There are three general ways in which a partnership may be dissolved:

1. By acts of the partners.
2. By a decree of court.
3. By operation of law

The most common method of dissolving a partnership is by acts of the partners. This may be the result of an agreement among the partners, the withdrawal of one of the partners, the sale or assignment of his interest by a partner, or the partnership having accomplished the purpose for which it was formed and the winding up of the business.

The court will decree a dissolution of a partnership, upon the application of one or more of its members, in case of the misconduct or incapacity of a member, or if the undertaking is impractical or incapable of being put in operation. Also, according to law, a dissolution of the partnership results in case of the death or bankruptcy of a member, the bankruptcy of the firm, or a declaration of war against a country of which one or more partners are citizens.

From an accounting viewpoint, the question of prime importance in case of a dissolution is the ascertainment of the profits or losses which have accrued since the end of the last fiscal period, and the correct showing of the amount of the proprietorship belonging to each partner as a result of the dissolution. It is not possible to discuss here the various technical questions both of a legal and an accounting nature which may arise in connection with the dissolution of a partnership, but sufficient has been said to indicate that the probability of a dissolution should not be ignored and that specific regulations with reference thereto should be included in the articles of copartnership.

Summary

No attempt has been made in the preceding discussion to give an exhaustive treatment of the legal and accounting problems involved in the formation, operation and dissolution of a partnership. For a discussion of these the student must refer to texts on commercial law and on accounting practice. It is hoped, however, that this discussion has pointed out those principles which will be of most service and of most frequent application in the operation of a business of which the ownership is vested in a partnership. It may be well to state again that the accounting records and practices of a partnership business are in the main the same as those for any other type. It is only in connection with certain transactions relating directly to the proprietorship that the procedure may be different. To point out this difference is the purpose of the preceding discussion.

QUESTIONS FOR CLASS DISCUSSION

1

A and B are partners in the furniture business. A, without B's knowledge or consent, orders, in the firm's name, a carload of furniture from the Grand Rapids Furniture Co. B contends that the purchase was not authorized and that the company will not pay for it. The Grand Rapids Furniture Co. sues the firm for the purchase price. Can they recover?

2

Suppose in the foregoing case A had ordered a carload of eggs from a cold storage company. What would the decision have been?

3

A, B and C are partners. A is killed. What happens to the partnership? Suppose before his death A had sold his interest to X. What would have been the result?

4

The partnership of Smith & Brown is insolvent. The partnership owes King, its chief creditor, $40,000.00. He receives from the liquidation of the business $32,000.00. What remedy has he with reference to the balance due him?

5

John Burke, who is cashier for the partnership of Rice & Meyers, is employed with an agreement that he is to receive ten per cent. of the net profits of the business as compensation for his services. Is Burke a partner? Why?

6

A. C. Jones and R. A. Sheppard form a partnership to engage in the hay and feed business. Jones invests $5,000.00 cash and Sheppard $3,000.00. Explain how the opening entries of the new firm will be made.

7

G. E. Frazer and A. W. Torbet form a partnership to engage in the retail hardware business. Frazer invests $2,000.00 in cash, $200.00 in notes receivable, merchandise inventory valued at $5,080.00, and office furniture valued at $480.00. The firm assumes

accounts payable of Frazer to the amount of $1,800.00. Torbet invests $2,800.00 in cash. Explain how the opening entries of the new firm will be made.

8

Frazer and Torbet have agreed that Frazer is to have active charge of the business and is to receive a compensation of $150.00 for his services. Explain how this salary should be recorded at the end of the month.

9

Wentworth and Clark form a partnership to engage in the retail grocery business. Wentworth invests $3,000.00 in cash and Clark invests $6,000.00. The partnership contract is oral and nothing is said with reference to the division of profits. At the end of the year their profits are $900.00. How should these profits be divided?

10

State and explain the different ways in which a partnership may be dissolved.

LABORATORY MATERIAL

Exercise No. 76

L. S. Lyon and C. S. Duncan form a partnership to engage in the retail hardware business. The business is to be conducted at 1230 63d street, Chicago. They are to make equal investments and to share profits and losses equally. Each partner is to devote his entire time to the business and is to receive a salary of $100.00 a month for his services.

Instructions: Assuming whatever other facts you deem necessary, prepare the articles of copartnership for Lyon & Duncan.

Exercise No. 77

J. Viner and L. C. Sorrell, retail merchants, enter into a partnership. Viner invests the following assets: cash, $1,500.00; notes receivable, $200.00; accounts receivable, $2,800.00; and merchandise inventory, $3,200.00. Sorrell invests the following assets: cash, $1,200.00; merchandise inventory, $4,400.00; and furniture and fixtures, $700.00. Viner owes trade creditors $1,400.00 and the partnership agrees to assume this liability.

Instructions: Prepare the opening entries for the partnership.

Exercise No. 78

The partnership agreement of Viner & Sorrell provides that the partners are to share profits in proportion to their investment. It further provides that the partners may withdraw $75.00 a month as salary. The partnership is formed on January 1, 1920. Viner withdrew $800.00 during the year and Sorrell $700.00. During the year profits amount to $2,200.00.

Instructions: Show the accounts of the partners which would be affected by the salaries and profits after the closing entries are made on December 31, 1920. Show withdrawals and salaries for year, each in one amount.

Exercise No. 79

On June 30, 1920, Messrs. Jones, Martin and Torr form a partnership. The investment of Mr. Jones is shown by the following Balance Sheet:

JAMES C. JONES
Balance Sheet, June 30, 1920

Cash	$ 1,200.00	Notes Payable	$ 2,200.00
Notes Receivable	200.00	Accounts Payable	3,860.00
Accounts Receivable	3,920.00	J. C. Jones, Prop.	13,300.00
Merchandise Inventory	8,240.00		
Office Furniture	800.00		
Buildings	2,000.00		
Land	3,000.00		
	$19,360.00		$19,360.00

The investment of Mr. Martin is shown by the following Balance Sheet:

ROBERT M. MARTIN

Balance Sheet, June 30, 1920

Cash	$ 800.00	Notes Payable	$2,100.00
Notes Receivable	200.00	Accounts Payable	1,940.00
Accounts Receivable	3,800.00	Accrued Wages	200.00
Merchandise Inventory	4,200.00	R. M. Martin, Prop.	5,500.00
Office Furniture	600.00		
Unexpired Insurance	140.00		
	$9,740.00		$9,740.00

Mr. Thomas L. Torr invests $5,000.00 in cash.

Instructions: 1. Make the entries necessary to record the foregoing investments on the books of the new firm.

2. Prepare a Trial Balance for the new firm as of June 30, 1920.

Exercise No. 80

The Balance Sheet of Davies, Jones & McGee on September 30, 1920, is as follows:

Cash	$ 2,200.00	Notes Payable	$ 1,200.00
Notes Receivable	300.00	Accounts Payable	2,800.00
Accounts Receivable	3,800.00	G. Davies, Prop.	4,000.00
Merchandise Inventory	5,600.00	H. Jones, Prop.	2,500.00
Furniture & Fixtures	600.00	H. McGee, Prop.	3,000.00
Delivery Equipment	1,000.00		
	$13,500.00		$13,500.00

1. Davies retires from the firm receiving cash $1,000.00 and a note signed by the new firm for $3,000.00.

Instructions: Show in journal form the entry necessary to give effect to his withdrawal.

2. Assuming that, instead of the withdrawal of Davies alone, all the partners decide to withdraw from the business. The assets are converted into cash with the following losses: accounts receivable, $200.00; merchandise inventory, $250.00; furniture and fixtures, $100.00. The liabilities are paid in full. The partners share profits and losses in proportion to their investment.

Instructions: Show the entries necessary to close the books and pay off the partners.

CHAPTER XX

THE BALANCE SHEET

Purpose of the Balance Sheet

The Balance Sheet is a report which presents information with reference to the assets, liabilities, and proprietorship of a business. This information serves two important purposes: first, it is used by the owner, or those who are responsible for the management of the business, as a basis for judging past results and for planning future operations; secondly, it serves as a means by which others can judge the advisability of entering into certain relations with the business. In the preceding chapters the use of the Balance Sheet by the officers and managers of the business has been emphasized, but it has been suggested that there are others who may desire to use it. An illustration or two, probably, will make its use in the latter way more apparent.

E. C. Cline & Co., who conduct a retail dry goods store in Little Rock, Ark., may desire to purchase merchandise on account from Marshall Field & Co. of Chicago. If this is their first order from Marshall Field & Co. the latter will desire to know their financial condition before shipping them the goods. Consequently, they will ask E. C. Cline & Co. to furnish a Balance Sheet of recent date. In addition, Marshall Field & Co. will look up the rating of E. C. Cline & Co. with the "mercantile agencies." The two principal mercantile agencies are Dun and Bradstreet. These agencies gather information with reference to the financial condition and credit standing of business firms upon the basis of which each firm is given a credit rating which they publish in a book or report that they sell to business houses. In order to estimate the financial condition of a firm they request a Balance Sheet which they use in connection with such other information as they have in forming their final estimate. In all probability, E. C. Cline & Co. each year furnish both of the mercantile agencies above mentioned with a Balance Sheet. It will be seen, therefore, that the Balance Sheet performs an important service in the buying and selling of merchandise on account.

If Marshall Field & Co. sell the merchandise mentioned above to E. C. Cline & Co. on account, payable in thirty days, it may be the

latter find at the end of that time that they have not sufficient funds to pay the amount due. They know that in thirty days more they will have sold sufficient merchandise to have the funds required, but they wish to pay the account at the time it is due to maintain their credit standing. Consequently, they arrange with their local bank to lend them the amount required to pay Marshall Field & Co. The method of obtaining this loan from the bank and the consequences will be discussed later. It is sufficient for the present to see that they obtain the funds desired from the bank, promising, probably, to repay them in thirty days. In order to judge their ability to repay the amount they desire to borrow, the bank, before granting them the loan, will require a Balance Sheet showing their financial condition. Here again it will be seen that the Balance Sheet performs a very useful function in the relations of the business with those outside of the business.

Again E. C. Cline & Co. may be considering the union of their store with that of E. H. White & Co., who are conducting a rival store. In this case, each of these firms will desire a Balance Sheet of the other before agreeing on the basis upon which they will unite.

At the end of their fiscal year E. C. Cline & Co. are required by the income tax law to file a report with the government showing the amount of the company's income for the year to be used as a basis of taxation. Under present practice the company will also have to submit a Balance Sheet which will assist the government officials in determining the amount of tax due. It can be seen, therefore, that the Balance Sheet may be of service in the relations of the business firm with the government.

Although the above are but a few of the many uses of the Balance Sheet, they are probably sufficient to indicate its importance as a financial report.

Nature of the Information on the Balance Sheet

The particular information which will appear on the Balance Sheet will depend somewhat upon the size of the business and the nature of its operations. A large manufacturing business will have a large amount of assets, such as land, buildings, machinery and equipment, which would be useless to a small retail grocery store. A bank will have a large amount of cash and notes receivable which the mercantile store will not have and the mercantile store will have a large quantity of merchandise which would not be owned by a bank. Consequently, the Balance Sheet of a manufacturing busi-

ness, a retail grocery store, and a bank will differ as to the amount and nature of the items which appear thereon. The function of the Balance Sheet and the principles governing its construction are quite similar, however, regardless of the nature of the business for which it is made.

In Chapter III a Balance Sheet has been given which contains the assets and liabilities which a medium size retail business might have. The discussion given in Chapter III was amplified somewhat in Chapter XVI. No attempt was made in either case, however, to give an exhaustive list of assets and liabilities, the primary purpose being to illustrate the function of the Balance Sheet and to explain the principles underlying its construction and interpretation. In a larger business the assets and liabilities will be more numerous and consequently the Balance Sheet will be expected to give additional information. It is the purpose of this chapter to further discuss the construction and interpretation of the Balance Sheet. Even here, however, the discussion of the Balance Sheet will by no means be complete, and it will be necessary to return to it again in future chapters after additional material with reference to business organization and administration has been given.

Classification of Balance Sheet Items

The items appearing on the Balance Sheet are divided into three main classes:

1. Assets.
2. Liabilities.
3. Proprietorship.

The assets of a business consist of all property or things of value which are being used in the conduct of the business. The liabilities of a business consist of the claims which those outside of the business have against its assets. The proprietorship is the difference between the total assets and the total liabilities and represents the interest of the owners in the business.

Each of these main classes may be subdivided and each subdivision may contain several items, so it will be necessary to discuss each of the above separately.

Classification of the Assets

The items appearing as assets on the Balance Sheet may be classified as: *current* assets and *fixed* assets.

Current assets are those which are in the form of cash or which presumably will be converted into cash in the regular operations of the business. They usually constitute a part of the business cycle of: (1) cash; (2) the exchange of cash for merchandise; (3) the exchange of merchandise for accounts receivable; and (4) the exchange of accounts receivable for cash. Consequently cash, accounts receivable, and merchandise inventory are usually the principal current assets. Sometimes notes are received in payment of merchandise or of accounts receivable, in which case notes receivable appears as a current asset. There are certain miscellaneous items which appear as current assets and these will be discussed in a subsequent chapter.

Fixed assets are those which have been purchased for use in the future operations of the business and which it is anticipated will not be disposed of while the business is operated unless they become worn out or obsolete. The fixed assets which are owned by a business depend to some extent on the nature and size of the business. In a mercantile business the fixed assets of most frequent occurrence are: office equipment, store fixtures, delivery equipment, building and land. Many retail stores, however, do not own the building and land where their business is conducted, but rent it instead. In a manufacturing business, in addition to the assets mentioned above, machinery and equipment may be items of considerable importance. The principal problem with reference to fixed assets is the showing of the decrease in value which arises as a result of their use in the business. The method of showing this is discussed in a subsequent paragraph in this chapter.

Classification of Liabilities

The items appearing as liabilities on the Balance Sheet may be classified as *current* liabilities and *fixed* liabilities. Current liabilities are those which will have to be paid within a relatively short time after they are incurred. They are incurred usually in order to purchase merchandise or to make it possible for the business to sell merchandise on account to its customers. The current liabilities which are of principal importance are accounts payable and notes payable. It is anticipated that the funds with which to pay such liabilities will be obtained from the liquidation of current assets.

Fixed liabilities are long time obligations; that is, those that probably will not be paid until a relatively long time after they

have been incurred. They are incurred usually in order to purchase fixed assets. Except in the case of manufacturing concerns they are not of frequent occurrence, so a further discussion of them will be postponed until after the organization and administration of manufacturing industries have been considered.

Proprietorship

As previously stated, the proprietorship of a business may be vested in a sole proprietor, a partnership, or a corporation. If vested in a sole proprietor, it is recorded on the Balance Sheet under the proprietor's name with some descriptive word such as "proprietor," "investment," or "capital" written after his name so as to clearly indicate the nature of the item. In a business owned by I. M. Waugh, the proprietorship of which is $5,000.00, it may be shown as follows:

I. M. Waugh, Proprietor	$5,000.00

In a partnership the proprietorship is indicated in the same way except that each partner's interest is shown separately. If R. M. Askin and W. T. Dickins are equal partners in a business which has a proprietorship of $6,000.00, their interests will be shown as follows:

R. M. Askin, Proprietor	$3,000.00
W. T. Dickins, Proprietor	3,000.00

The method of showing the proprietorship of a corporation on the Balance Sheet will be shown in a subsequent chapter.

Relation of Current Assets to Current Liabilities

As previously stated, the current liabilities usually consist of accounts payable and notes payable. The accounts payable are incurred in the purchase of merchandise and the notes payable are either given in payment of merchandise or given to a bank in order to obtain funds with which to pay accounts payable. The current liabilities are incurred in connection with the purchase of merchandise and it is expected that the funds to pay them will be obtained from the sale of merchandise or the liquidation of claims arising as a result of the sale, such as notes receivable and accounts receivable. This should be apparent, for it will be realized that the business does not anticipate selling its fixed assets, such as office furniture, building, land, etc., in order to pay its debts. Since,

therefore, the current liabilities are to be paid from the current assets the creditors desire as a matter of safety that the latter be considerably in excess of the former.

Banks, since they make short-time loans to their customers which they expect to be paid by the early liquidation of current assets, put especial emphasis on the ratio of current assets to current liabilities. In the past they have insisted quite arbitrarily on the "two to one" rule; that is, the current assets must be twice the current liabilities. Of late, they have learned that such a rule can not be followed blindly and that the nature of the business must be taken into consideration, but they still insist that an approximation of the above ratio be maintained in most businesses. In trying to judge the financial condition of a business from its Balance Sheet, the ratio of current assets to current liabilities must always be taken into consideration, and a business should be considered in a precarious condition if its current assets do not exceed its current liabilities by a safe margin.

Method of Determining the Value of Certain Assets

The Balance Sheet should show as nearly as possible the financial condition of a business on a particular date. In order to do this it is necessary that care be exercised to avoid overstating any of the assets. The value of some of the assets of a business at the end of a fiscal period can be obtained from the ledger accounts, but there are others the correct value of which is not shown by the ledger record. It is necessary to see, therefore, what these assets are and how their value is to be determined.

The business man soon learns by experience that each year he sells goods to customers who fail to pay him. This is true, no matter how carefully he may select those to whom he sells on account. If, for instance, Cline & Pipkin, retail merchants, have $2,600.00 due from customers at the end of the year, they may not be able to collect more than $2,548.00. They do not know, probably, which customers will not pay, but they know from past experience that about two per cent of the amount due from customers will prove uncollectible. They estimate, therefore, that two per cent of the $2,600.00 due them, or $52.00, will prove uncollectible this year.

If Cline & Pipkin estimate that they will be able to collect only $2,548.00 from their customers, it is undesirable for them to place

debts due from customers on the Balance Sheet as $2,600.00. Although the loss has not yet taken place, it is desirable that allowance be made in some way for the $52.00 they anticipate being unable to collect. This may be done by subtracting the $52.00 from the $2,600.00 due and showing their accounts receivable on the Balance Sheet as $2,548.00. This method is employed frequently, but since the $52.00 represents only the estimated amount of uncollectible debts and adjustments may have to be made later, it is thought by accountants and business men desirable to show the gross amount of the accounts receivable with the estimated allowance for bad debts subtracted therefrom. In accounting this estimated allowance is known by the technical term of *reserve for bad debts.* The reason for this terminology will be more apparent after later chapters have been studied. On the Balance Sheet of Cline & Pipkin this would be shown as follows:

Accounts Receivable	$2,600.00	
Less: Reserve for Bad Debts . .	52.00	$2,548.00

In addition to accounts receivable the owner of the business has certain other assets the correct value of which is usually not shown on the accounting records at the end of the year or fiscal period when the Balance Sheet is made. All fixed assets with the exception of land are continually decreasing in value, due to use in the business and increasing age. This decrease in value is not reflected in the accounts day by day as it takes place. It is necessary, therefore, at the end of the fiscal period to estimate the amount which such assets have decreased in value during the period and to subtract the amount from their value as shown on the accounting records.

If Cline & Pipkin, the retail merchants mentioned, have office equipment which they purchased for $800.00 on January 1st, and they estimate this equipment will be of service for ten years, they would subtract $80.00 from the original cost of $800.00 and show this equipment at $720.00 on the Balance Sheet. It is usually deemed desirable to indicate this subtraction on the face of the Balance Sheet for the same reasons that the reserve for bad debts is shown on the Balance Sheet. The decrease in value of a fixed asset because of its use in the business is known as depreciation and the estimated amount of such depreciation is known as a *reserve for depre-*

ciation. Hence on the Balance Sheet of Cline & Pipkin their office equipment would appear as follows:

Office Equipment	$800.00	
Less: Reserve for Depreciation . .	80.00	$720.00

All other fixed assets with the exception of land are shown in the same way; that is, the original cost of the assets with the exception of land are shown in the same way; that is, the original cost of the assets with the accumulated depreciation subtracted therefrom is shown on the Balance Sheet.

Form of the Balance Sheet

A Balance Sheet containing the items discussed above may be as follows:

CLINE & PIPKIN

BALANCE SHEET, DECEMBER 31, 192..

Assets					
Current Assets:					
Cash		500	00		
Notes Receivable		400	00		
Accounts Receivable	2600.00				
Less: Reserve for Bad Debts	52.00	2548	00		
Merchandise Inventory		2000	00		
Total Current Assets				5448	00
Fixed Assets:					
Office Equipment	800.00				
Less: Reserve for Depreciation	80.00	720	00		
Delivery Equipment	400.00				
Less: Reserve for Depreciation	36.00	364	00		
Building	2000.00				
Less: Reserve for Depreciation	100.00	1900	00		
Land		1500	00		
Total Fixed Assets				4484	00
TOTAL ASSETS				9932	00
Liabilities					
Current Liabilities:					
Notes Payable - Trade Creditors		200	00		
Notes Payable - Bank		1400	00		
Accounts Payable		1000	00		
Total Liabilities				2600	00
Proprietorship					
E. C. Cline, Proprietor		4000	00		
J. G. Pipkin, Proprietor		3332	00		
Total Proprietorship				7332	00
TOTAL LIABILITIES AND PROPRIETORSHIP				9932	00

Illustration No. 29—Balance Sheet

QUESTIONS FOR CLASS DISCUSSION

1

R. M. Long, a retail merchant of Wichita, Kans., desires to purchase on account $500.00 worth of merchandise from James Peabody & Co., wholesalers of St. Louis, Mo. What information would Peabody & Co. desire to obtain with reference to R. M. Long before they ship the merchandise to him? How would Peabody & Co. obtain this information?

2

After examining the financial condition of R. M. Long, Peabody & Co. ship him the $500.00 worth of merchandise, terms 2/10, n/30. These terms mean that two per cent may be deducted from the face of the invoice if it is paid within ten days and that the full amount is due within thirty days. Long desires to pay the account within the ten-day period so as to obtain the discount. Not having the cash available he requests his local bank to lend him the amount. Assuming that he has not previously borrowed from his bank, what information will the bank desire to obtain before making the loan? How will it obtain this information?

3

The Ford Company manufacture automobiles. They own their factory, machinery, and equipment. The Smith Company are engaged in the retail grocery business. They rent the building in which their business is conducted, but own the furniture and equipment in the store. In what ways will the Balance Sheets of these two firms differ?

4

J. H. Bishop, retail merchant, presents to his bank the following Balance Sheet:

Financial Statement, July 31, 1920

Real Estate	$ 4,000.00	Net Worth	$ 8,300.00
Cash	800.00	Due to Creditors	2,600.00
Bills Receivable	300.00	Bills Payable	1,600.00
Furniture & Fixtures	400.00		
Due from Customers	2,800.00		
Merchandise	4,200.00		
	$12,500.00		$12,500.00

Explain how this Balance Sheet should be changed in order to provide more information and to correspond to current accounting practice.

5

W. C. Fields, a retail dry goods merchant, orders merchandise on account from C. M. Simons & Co., wholesale dry goods merchants. Upon the request of Simons & Co., Mr. Fields submits the following Balance Sheet:

W. C. FIELDS

Balance Sheet, April 30, 1920

Cash	$ 800.00	Notes Payable	$ 1,920.00
Notes Receivable	100.00	Accounts Payable	2,900.00
Accounts Receivable	2,900.00	Net Worth	13,280.00
Merchandise Inventory	8,000.00		
Furniture & Fixtures	300.00		
Delivery Equipment	1,000.00		
Buildings	3,000.00		
Land	2,000.00		
	$18,100.00		$18,100.00

Assuming that the order of Mr. Fields is for $580.00, will Simons & Co. on the basis of this Balance Sheet be justified in shipping the merchandise?

6

C. M. Riley, a retail dry goods merchant, asks his bank for a loan of $20,000.00. He presents the following Balance Sheet:

C. M. RILEY

Balance Sheet, December 31, 1920

Cash	$ 1,000.00	Accounts Payable	$ 75,000.00
Notes Receivable	5,000.00	Notes Payable	25,000.00
Accounts Receivable	20,000.00	C. M. Riley, Prop.	44,000.00
Merchandise Inventory	100,000.00		
Furniture & Fixtures	10,000.00		
Delivery Equipment	8,000.00		
	$144,000.00		$144,000.00

On the basis of this report would the bank be justified in granting the loan?

7

On January 1, 1910, E. C. Cline, a hardware dealer, purchased a delivery truck for $1,000.00, and a store building for $7,000.00. In 1920 he constructs the following Balance Sheet:

E. C. CLINE
Balance Sheet, December 31, 1920

Cash	$10,000.00	Notes Payable	$ 1,000.00
Merchandise	50,000.00	Accounts Payable	20,000.00
Delivery Equipment	1,000.00	Proprietorship	49,000.00
Land and Building	7,000.00		
Store Equipment	2,000.00		
	$70,000 00		$70,000.00

What criticism would you offer of the foregoing Balance Sheet?

8

The James A. Hoff Wholesale Company find by an inspection of their records that during the years 1916, 1917 and 1918 that the total uncollectible accounts were one per cent of the total sales on account. In 1919 their sales on account amounted to $90,000.00. The accounts receivable outstanding are $28,000.00. Explain how the accounts receivable should be shown on the Balance Sheet.

E. C. King has submitted to his bank in asking for credit a Balance Sheet dated January 1, 1920. Examination reveals no allowance made for bad debts nor for depreciation on fixed assets. You are instructed by the credit manager of the bank to make an inspection of the records of King to determine the amount that should be deducted as a reserve for bad debts and as a reserve for depreciation. Explain what information you should obtain in order to determine the amount of these reserves.

10

H. M. Jones and D. C. Brown, partners in the retail hardware business, submit to their bank a Balance Sheet made as follows:

JONES & BROWN
Balance Sheet, September 30, 1920

ASSETS:		LIABILITIES:	
Current Assets	$10,000.00	Current Liabilities	$ 8,000.00
Fixed Assets	20,000.00	Proprietorship	22,000.00
	$30,000.00		$30,000.00

You are asked by the bank to explain to Mr. Jones and Mr. Brown how this Balance Sheet should be revised in order to give the information which the bank desires. State the instructions which you would give to Jones & Brown.

LABORATORY MATERIAL

Exercise No. 81

The Trial Balance of Baker & Peters on June 30, 1920, is as follows:

BAKER & PETERS

Trial Balance, June 30, 1920

Cash	$ 1,800.00	
Notes Receivable	300.00	
Accounts Receivable	3,200.00	
Merchandise Inventory, June, 1919	4,800.00	
Furniture and Fixtures	600.00	
Reserve for Depreciation of Furn. & Fix.		$ 120.00
Delivery Equipment	1,000.00	
Reserve for Depreciation of Del. Equip.		200.00
Buildings	4,000.00	
Reserve for Depreciation of Buildings		1,600.00
Land	2,000.00	
Notes Payable		1,400.00
Accounts Payable		2,600.00
J. W. Baker, Proprietor		6,000.00
J. W. Baker, Personal	220.00	
P. B. S. Peters, Proprietor		7,380.00
P. B. S. Peters, Personal	280.00	
Sales		36,000.00
Purchases	34,000.00	
Selling Expenses	1,240.00	
Administrative Expenses	1,860.00	
	$55,300.00	$55,300.00

The merchandise inventory on June 30, 1920, is $8,000.00. The loss on bad debts is estimated to be two per cent of the accounts receivable outstanding. The depreciation on fixed assets is as follows:

Furniture and Fixtures	10% of cost
Delivery Equipment	20% of cost
Buildings	5% of cost

Profits and losses are shared equally by the partners.

Instructions: Prepare a Balance Sheet for Baker & Peters as of June 30, 1920.

Exercise No. 82

You have $15,000.00, which you desire to invest in a retail dry goods business. Three different businesses are offered to you for this sum. The following are the assets and liabilities of the three firms:

"A" Dry Goods Co.

1. Notes Receivable	$ 5,000.00
2. Land and Buildings	10,000.00
3. Merchandise Inventory	12,000.00
4. Furniture and Fixtures	4,000.00
5. Notes Payable to Bank	1,000.00
6. Notes Payable to Mdse. Cred.	13,000.00
7. Cash	10,000.00
8. Accounts Payable	15,000.00
9. Accounts Receivable	3,000.00

"B" Dry Goods Co.

1. Land and Buildings	$ 2,000.00
2. Cash	1,000.00
3. Notes Receivable	100.00
4. Notes Payable to Creditors	1,000.00
5. Accounts Payable	5,000.00
6. Accounts Receivable	4,000.00
7. Notes Payable to Bank	4,000.00
8. Merchandise Inventory	17,000.00
9. Furniture and Fixtures	900.00

"C" Dry Goods Co.

1. Cash	$ 3,000.00
2. Merchandise Inventory	65,000.00
3. Accounts Payable	63,000.00
4. Land and Buildings	8,000.00
5. Notes Receivable	7,000.00
6. Notes Payable to Bank	5,000.00
7. Accounts Receivable	22,000.00
8. Furniture and Fixtures	13,000.00
9. Notes Payable to Mdse. Cred.	35,000.00

Instructions: 1. Prepare in proper form a Balance Sheet for each firm. Depreciation is not to be considered in preparing these Balance Sheets.

2. State clearly in outline form what information in addition to the foregoing Balance Sheets you would desire in determining which company you would prefer to purchase.

3. Considering the Balance Sheets only, in which company would you prefer to invest? Give clearly and fully the reasons for your answer. Your reasons should be based on an analysis of the Balance Sheets and the ratios existing between the various items thereon.

EXERCISE No. 83

A Trial Balance of the ledger of J. K. Pines on December 31, 1919, after the adjusting and closing entries have been made, is as follows:

Cash	$ 800.00	
Notes Receivable	200.00	
Accounts Receivable	3,800.00	
Merchandise Inventory	4,200.00	
Furniture and Fixtures	600.00	
Reserve for Depreciation of Furniture and Fixtures		$ 120.00
Buildings	3,000.00	
Reserve for Depreciation of Buildings		750.00
Land	2,000.00	
Notes Payable		2,000.00
Accounts Payable		2,300.00
J. K. Pines, Proprietor		9,430.00
	$14,600.00	$14,600.00

A Trial Balance made at the same time one year later on December 31, 1920, is as follows:

Cash	$ 300.00	
Notes Receivable	1,800.00	
Accounts Receivable	3,200.00	
Merchandise Inventory	5,600.00	
Furniture and Fixtures	600.00	
Reserve for Depreciation of Furniture and Fixtures		$ 120.00
Buildings	3,500.00	
Reserve for Depreciation of Buildings		750.00

Land	2,500.00	
Notes Payable		4,000.00
Accounts Payable		2,300.00
J. K. Pines, Proprietor		10,330.00
	$17,500.00	$17,500.00

Instructions: 1. Prepare a Balance Sheet for Pines as of December 31, 1919 and as of December 31, 1920.

2. Explain with reasons on which date you think the financial condition of Pines is the better.

CHAPTER XXI

THE STATEMENT OF PROFIT AND LOSS

Purpose of the Statement of Profit and Loss

The primary purpose of business investment being to earn a profit it should be apparent that those who are responsible for the management of a business desire information of two kinds at the end of a fiscal period: first, they desire information which will show them the amount of profit made during the past period; second, they desire information which will show them how to plan an increase of the amount of profit for the next period. Of course, if the business has been unsuccessful and a loss instead of a profit has resulted from its operations, they are equally anxious to know the amount of the loss and how it can be eliminated.

The Balance Sheet shows the amount of the proprietorship, and by comparing this with the proprietorship item shown on the preceding Balance Sheet, the profit or loss for the period can be determined, provided the proprietors have not withdrawn or added to their investment during the period. The Balance Sheet at the most, however, shows only indirectly the cause or reason for this profit or loss. To obtain the reason for the profit or loss resulting from the operations of the period, a statement must be prepared which gives the source and amount of the income and the nature and amount of the expense incurred in earning this income. This statement is frequently called the Statement of Profit and Loss. The student will find in his study of accounting that this statement is known by various names. The name by which it is known is more or less immaterial, as long as it is descriptive. Its purpose in any case is the same—to show the net profit or loss for a certain period of time and the causes therefor.

Classification of the Items on the Statement of Profit and Loss

The profit or loss resulting from the operations of a business is the difference between its income and its expenses. The income of a business may be classified as *operating* income: that which results from the operations for which it is primarily organized and conducted; and *non-operating* income: that which arises incidental to its main operations. For instance, the purpose of a dry goods store

is to sell merchandise and derive an income therefrom. Consequently, the income derived from this source by such a store is termed *operating* income. On the other hand, if the management of the store finds some surplus funds on hand during one season of the year and loans them to another merchant, receiving pay for their use, the income thus received is termed *non-operating* income, for it is the purpose of a mercantile store to sell goods, not to loan money.

Similarly, the expenses of a business are classified as *operating* expenses: those incurred in carrying on the regular operations of the business; and *non-operating* expenses: those incurred in carrying on certain incidental operations. For instance, the expenses incurred by a merchant in the buying and selling of his merchandise are operating expenses, while the expenses incurred in the buying and selling of some bonds are non-operating expenses, for it is not the function of a mercantile store to deal in bonds. Such operations are incidental to the main operations of the business.

In view of the above discussion it may be seen that the items on the Statement of Profit and Loss may be classified under the following heads:

1. Operating Income.
2. Operating Expenses.
3. Non-operating Income.
4. Non-operating Expenses.

Operating Income

In a mercantile business the operating income is obtained as a result of the purchase and sale of merchandise. Its amount is determined by the difference between the cost and the selling price of the merchandise sold. It will be readily seen, therefore, that in the discussion of the operating income of such a business two things must be considered—the returns from sales, and the cost of the goods sold.

Returns from Sales

The Statement of Profit and Loss begins with a statement of the amount received from sales. In a mercantile business, as stated above, this is the amount received from the sale of merchandise. In some lines of business, such as that of a firm of lawyers or accountants, not merchandise but services are sold. In this case the first item on the Statement of Profit and Loss would be the

income from services rather than the returns from sales. In a bank the chief income is derived from the sale of the use of money. Funds are loaned to customers of the bank and a certain sum known as *interest* is charged for the use of this money. When the bank makes a Statement of Profit and Loss the first item will be a statement of the interest received, instead of the returns from sales. Thus in the case of any business the operating income from whatever source received is shown as the first item on the Statement of Profit and Loss. The present discussion will be confined to a consideration of the Statement of Profit and Loss for a mercantile firm. The principles governing its construction and interpretation are the same as for other lines of business, though the name and number of the items appearing thereon may show considerable variation.

Sales Deductions

Usually the first item appearing on the Statement of Profit and Loss is the *gross sales.* This item is the total of all goods invoiced to customers. There are certain deductions, however, which have to be made from the gross sales in order to determine the net sales, the amount for which the customer assumes liability. Although these deductions may be of various kinds, those of principal importance and of usual occurrence may be classified as:

1. Sales Returns.
2. Sales Allowances.

Sales returns are goods which have been sold and later returned by the customer. They may be returned because the wrong goods were shipped, because they were defective or damaged, or for any other reason which made them unsuitable for the use the purchaser intended. The consent of the seller should be obtained before they are returned, but this is usually given if the purchaser can show that their unsuitability for his use is due to the fault of the seller.

Sales allowances are deductions from the sales price granted by the seller to the purchaser because of defects in the goods or damages incurred which render them less valuable to the latter. If the goods are entirely unsuitable for the use of the purchaser they will be returned, while if they are of some value to him but not worth their purchase price he may retain them but ask for a reduction from the invoice price. Sometimes sales returns and sales allowances are shown as one item, but this is undesirable, as there is a considerable difference between these two items. In the case of sales

allowances there is a loss for the total amount, while if goods are returned they are usually of some value, so there is only a partial loss.

These items are shown on the Statement of Profit and Loss as follows:

Gross Sales		$11,000.00
Less: Sales Returns	$20.00	
Sales Allowances	25.00	45.00
Net Sales		$10,955.00

Sometimes the seller prepays the freight on merchandise sold and shipped to the customer. If it is the practice of the firm to prepay freight on all goods sold, this is a proper deduction from the sales price and should be added to the items of returned sales and sales allowances as shown above and be subtracted from the gross sales. If the freight, however, is paid only on occasional orders of new customers and is paid as an inducement to the customer to place the order, it should be regarded as a selling expense and not as a deduction from the gross sales.

Cost of Goods Sold

In the case of a going concern there are certain goods on hand at the beginning of the fiscal period. We have seen that these goods are known as the merchandise inventory. The value of the inventory is obtained by taking a physical count to obtain the quantity and taking the cost price or the market price, whichever is the lower, as the basis of valuation. During the fiscal period goods are purchased and added to the beginning inventory. At the same time sales are being made and these sales are made indiscriminately from the goods on hand at the beginning of the period and those purchased during the period. At the end of the fiscal period it is necessary to know the cost of goods sold in order to determine the profit made. This is not shown by the records as they are usually kept. The inventory at the beginning and the purchases made during the period are shown by the Inventory and Purchases accounts respectively, and the amount of the sales is shown in the Sales account, but nowhere is the cost of the goods sold shown. It is obvious if no goods had been sold that the value of the merchandise on hand at the end of the period would be the sum of the beginning inventory and the purchases. But sales have been made and the amount on hand is much less than the above amount. By taking a physical

inventory the value of the goods on hand may be obtained, and if this is subtracted from the beginning inventory plus the purchases, it must be assumed that the difference represents the cost of the goods sold.

By way of illustration, it may be assumed that the beginning inventory is \$3,000.00 and the purchases during the period are \$10,000.00. Then, obviously, if no sales had been made there would be \$13,000.00 worth of merchandise on hand at the end of the period. But sales have been made and an inventory shows only \$5,000.00 worth of merchandise on hand. Since \$13,000.00 worth of merchandise has been put in the store during the period and there is only \$5,000.00 there now, it must be assumed that the difference, or \$8,000.00, represents the cost of the goods sold.

From the above discussion it should be apparent that the chief difficulty in obtaining the cost of goods sold is in determining the value of the beginning and ending inventories and the cost of the goods purchased. After these are determined, it is only a matter of arithmetic to ascertain the cost of goods sold. The method of determining the value of the inventories has been discussed sufficiently for the present, although it will be necessary to return to it later. It is necessary, however, to discuss at this time the method of determining the cost of the merchandise purchased.

The invoice received from the seller shows the amount which the purchaser has contracted to pay for the merchandise purchased. On the accounting records it is customary to debit Purchases and credit the creditor for the amount of the invoice. At the end of the period, therefore, the total of the Purchases account shows the invoice cost of merchandise purchased. In the case of purchases, as well as sales, however, there are certain deductions. These deductions usually consist of returned purchases and purchases allowances. The former are purchases which have been returned to seller and the latter are deductions allowed by the seller from the invoice price. The reasons for these returns and allowances are the same as those stated for sales returns and sales allowances. They represent deductions from invoice cost and are so shown on the Statement of Profit and Loss. Another item which must be considered in arriving at the cost of purchases is freight and drayage. Usually the purchaser pays the freight charges on the goods purchased and also incurs certain expenses in connection with the transfer of the goods from the station of the transportation company to the store-room of his business. These expenses are a part

of the cost of goods purchased and are shown as an addition to the invoice cost on the Statement of Profit and Loss.

The cost of goods sold may be shown on the Statement of Profit and Loss as follows:

COST OF GOODS SOLD:

Merchandise Inventory, January 1, 192			$3,000.00	
Purchases		$8,000.00		
Freight and Drayage		800.00		
		8,800.00		
Less Purchases Returned	$200.00			
Purchases Allowances	100.00	300.00		
Net Purchases			8,500.00	
Total Purchases and Beginning Inventory			11,500.00	
Merchandise Inventory, December 31, 192			4,000.00	
Cost of Goods Sold				$7,500.00

As shown in the illustration of the Statement of Profit and Loss given at the end of this chapter, the cost of goods sold is subtracted from the net sales in order to determine the gross profit on sales.

Operating Expenses

The nature and amount of the operating expenses are determined by the size, nature and organization of the business. It is necessary to know what the operations of a business are before it is possible to discuss the expenses which will be incurred in carrying on these operations. In a mercantile business, since the principal operations are in connection with the purchase and sale of merchandise, it will be apparent that the expenses incurred in connection with buying, usually known as *buying* expenses, and those incurred in connection with sales and known as *selling* expenses, are two principal items. In addition to these, certain expenses known as *administrative* expenses are incurred in the general administration of the business. In a retail business where goods are delivered to the customers, there is another item of expense known as *delivery* expense. This item also occurs in a wholesale business, since it is necessary to deliver the goods sold to the railroad station. In connection with a wholesale business it is sometimes called drayage instead of delivery expense. In a business where large stocks are carried, and as a consequence a large warehouse maintained, the item of *warehouse* expense will be found. In a manufacturing business certain expenses known as manufacturing expenses will be incurred

in connection with the manufacturing operations. In different lines of business where other operations are performed other items of operating expense will occur. In the present discussion of the Statement of Profit and Loss only the first four items mentioned—that is, buying, selling, delivery and administrative expenses—will be considered. In later chapters other kinds of expense will be considered and illustrated.

The expenses incurred in connection with any one of the above operations of the business—buying, selling, delivering and administering—may be shown under several heads in order to indicate their particular nature. For the sake of brevity and simplicity it will be assumed for the present that all the expenses of each operation are recorded in one account and shown as one item on the Statement of Profit and Loss. If kept in separate accounts they would be shown on the statement under the main headings suggested above. For instance, the selling expenses might be shown as follows:

SELLING EXPENSES:		
Salaries and Wages of Sales Force . .	$300.00	
Advertising	170.00	
Miscellaneous	10.00	
Total Selling Expense		$480.00

If only the four accounts mentioned above are kept with operating expenses they will be shown on the Statement of Profit and Loss as follows :

OPERATING EXPENSES:		
Buying Expenses	$ 158.00	
Selling Expenses	480.00	
Delivery Expenses	250.00	
Administrative Expenses . . .	1,170.00	
Total Operating Expenses . .		$2,058.00

In a subsequent chapter the particular items which may constitute the buying, selling, delivery and administrative expenses will be indicated in connection with the construction and interpretation of the accounts kept with these expenses.

Non-Operating Income

If a business receives income from any source other than the regular operations of the business it is considered as non-operating income and shown separately on the Statement of Profit and Loss. In a mercantile store the regular operations consist of the purchase and sale of merchandise. If part of the funds are used to purchase some real estate which is later sold at a profit, this income should be shown separately from the income derived from the operation of the store. It should be readily apparent why the income from these two sources should be kept separately. If they are not, it will be impossible to judge the success of the operation of the store or of the miscellaneous transactions. If considerable income is derived from some outside source and added to the income from the store, it might make the operation of the store seem quite profitable when in fact it was otherwise. On the other hand, if losses result from the outside transactions and they are combined with the income from the store, it might make the store appear as an unsuccessful enterprise when in fact it was quite profitable. The same is true in any business, for no correct statement of the results of its operation can be obtained if operating and non-operating income are not separated.

The items of non-operating income which may appear on a Statement of Profit and Loss are so numerous and so varied that a discussion of all the particular kinds is impossible. However, the two which are of such frequent occurrence that it is thought advisable to discuss them here are:

1. Interest.
2. Purchases Discount.

Interest may be received by the business from customers who owe on notes or long time accounts or it may be received from the bank on money left on deposit. Not all money deposited in the bank bears interest, but the bank usually agrees that if funds are left in sufficient amount and for a certain length of time interest will be paid. It is not the function of a mercantile business to loan money, hence income derived from this source is non-operating income.

Merchandise is frequently purchased on terms which provide that if it is paid for within a stipulated time a certain percentage may be taken off the invoice price. For instance, $500.00 worth of merchandise may be purchased from King & Co. with the agreement

that payment may be deferred for thirty days, but if paid within ten days, two per cent may be deducted from the invoice price of $500.00. If the business pays King & Co. $490.00 within ten days this satisfies its obligation and a saving of $10.00 has been made. Such a saving may be made in connection with a considerable part of the goods purchased if the business has funds with which to pay bills promptly. Such deductions are known as purchases discount. There has been much discussion how purchases discount should be shown on the Statement of Profit and Loss. Some contend they should be shown as a deduction from purchases and others that they be shown as non-operating income. In another part of this text the arguments pro and con for each of these methods are given. For the present it is sufficient to say that the majority of accountants treat them as a non-operating income. Since the amount is not usually under the control of the purchases department, but is determined by those who are responsible for the financial management of the business, this method would seem to be preferable.

The non-operating income is frequently shown on the Statement of Profit and Loss under the heading of "Other Income" or "Income from Other Sources." It is usually placed just below the operating expenses and may appear as follows:

OTHER INCOME:		
Interest Received	$15.00	
Purchases Discount	30.00	
Total Other Income		$45.00

Non-Operating Expense

The nature of non-operating expense and the distinction between operating and non-operating expense have been discussed. Operating and non-operating expenses should be shown separately for the same reasons given above for the separation of operating and non-operating incomes. No statistics by which to judge efficiency or to plan future operations are possible if these items are not recorded and reported separately. The items of non-operating expense which may occur in connection with various lines of business are innumerable, but the two of most frequent occurrence are:

1. Interest.
2. Sales Discount.

Interest may be paid to creditors because of notes or long time accounts due them or it may be paid to a bank because of money borrowed from it to pay the debts of the business. In either case it is treated as a non-operating expense. It may be difficult for the student to see why interest is treated as a non-operating expense. It will be easier for him to see this if he will think of a particular illustration. If A. B. King is conducting a retail dry goods store in which he has invested $50,000.00 and borrows no money from the bank and issues no notes to customers, he will pay no interest. If he makes $5,000.00 profit from the operation of the store, there will be no deduction for interest and he may retain the entire amount. If, however, he is conducting the same store but has only $40,000.00 of his property invested in it, it may be necessary for him to borrow on the average $10,000.00 a year from his local bank. For the use of the bank's money he pays, or promises to pay, say $600.00. At the end of the year the profits of the business have not decreased, because part of the property with which it is conducted has been provided by the bank. The only difference is that A. B. King will not be able to retain the entire $5,000.00 profits, for he must give the bank $600.00 for the use of its money. So the interest paid is treated as a non-operating expense or, as more frequently termed, a "deduction from income."

Sales discounts are, from the viewpoint of a particular firm, the direct opposite of purchases discounts, and for the same reason that the latter are treated as "other income" the former are treated as "deductions from income."

On the Statement of Profit and Loss the non-operating expenses, frequently listed as "deductions from income," are shown immediately below the non-operating or "other income."

The two items of non-operating expense discussed above may be shown on the Statement of Profit and Loss as follows:

DEDUCTIONS FROM INCOME:		
Interest Paid	$40.00	
Sales Discount	30.00	
Total Deductions from Income .		$70.00

Form of the Statement of Profit and Loss

The Statement of Profit and Loss, containing the items discussed in this chapter, may be made as in Illustration No. 30, page 289.

A. L. ANDERSON & CO.

Statement of Profit and Loss for Year Ending December 31, 192..

GROSS SALES					11000	00
Less: Sales Returns			20	00		
Sales Allowances			25	00	45	00
Net Sales					10955	00
COST OF GOODS SOLD						
Merchandise Inventory, Jan. 1, 192.			3000	00		
Purchases		8000.00				
Freight and Drayage In		800.00				
		8800.00				
Less: Purchases Returned	200.00					
Purchases Allowances	100.00	300.00				
Net Purchases			8500	00		
Total Purchases and Beginning Inventory			11500	00		
Merchandise Inventory, Dec. 31, 192.			4000	00		
Cost of Goods Sold					7500	00
Gross Profit on Sales					3455	00
OPERATING EXPENSES						
Buying Expenses			158	00		
Selling Expenses			480	00		
Delivery Expenses			250	00		
Administrative Expenses			1170	00		
Total Operating Expenses					2058	00
Net Operating Profit					1397	00
OTHER INCOME						
Interest Received			15	00		
Purchases Discount			30	00		
Total Other Income					45	00
Gross Income					1442	00
DEDUCTIONS FROM INCOME						
Interest Paid			40	00		
Sales Discount			30	00		
Total Deductions from Income					70	00
Net Income					1372	00

Illustration No. 30—Statement of Profit and Loss

QUESTIONS FOR CLASS DISCUSSION

1

Douglas C. Johnson operates a retail clothing store. He owns the building in which his business is conducted and rents that part which he does not need for the use of the store. Explain how you would show the rent received on a Statement of Profit and Loss.

2

The Mercantile Trust Company receives $10,000.00 from interest on notes receivable during the year of 1920. How would this item be classified on a Statement of Profit and Loss of the bank?

3

The Mercantile Trust Company, in addition to its banking business, conducts a real estate business. Their gross income from the real estate business for the year 1920 amounts to $5,000.00. The expenses incurred in connection with the real estate department amount to $3,000.00. Explain how the real estate income and expenses should be shown on a Statement of Profit and Loss for the bank.

4

In preparing a Statement of Profit and Loss for William West, what would be the first item which would appear on it in case West is a lawyer? A banker? A retail grocer? Would the general principles governing the construction and interpretation of the Statement of Profit and Loss be different or the same in the three cases?

5

Kenneth Mather, a retail dealer in men's furnishings, sells $20,000.00 worth of men's suits during the year 1919. Customers return to him $200.00 worth of clothes which have been damaged by moths. He also grants reductions from the selling price amounting to $150.00 to customers who retained suits that were slightly damaged. In preparing Mather's Statement of Profit and Loss, how should the foregoing items be shown?

6

The H. B. Long Wholesale Company make it a general practice to prepay the freight on the goods sold to customers. How should this item be shown on their Statement of Profit and Loss? If it is

not their general practice to prepay freight, but they do so occasionally in order to obtain additional orders, how would it be shown on the Statement of Profit and Loss? Explain why it is treated differently in the two cases.

7

Mr. Watson, a retail merchant, has prepared a Statement of Profit and Loss on which he has stated both his beginning and ending inventory at selling price. Mr. Watson contends that this method shows his cost of goods sold properly. State how you would explain to him why he should not follow this practice.

8

The Boyd Mercantile Company purchase $50,000.00 worth of merchandise during 1920. They pay $1,250.00 freight and drayage on these purchases. They return $450.00 of this merchandise to their creditors and in addition are allowed a $100.00 reduction from the purchase price on goods which are slightly damaged. Their merchandise inventory on January 1, 1920, was $20,000.00 and on December 31, 1920, is $15,000.00. Explain how the cost of goods sold by this company during the year 1920 can be obtained

9

In the foregoing case assume that net sales for the year are $70,000.00. What is the gross profit on sales? What other items must be considered after gross profit on sales is determined before the success of the operation of the business for the year 1920 can be determined?

10

Explain the principal classes of operating expenses and state the nature of the items included in each class.

11

James Brown conducts a grocery business. In 1920 he sells a piece of property adjoining his store on which he makes a profit of $2,500.00. His grocery business results in a loss for the year 1920, but his Statement of Profit and Loss shows a net gain of $2,000.00 due to the inclusion of the profit from the sale of the property. Explain to Mr. Brown how he should show the profit on the property so that the loss arising from the conduct of his grocery store will not be hidden.

12

Assuming that Mr. Brown did not discover that his grocery business was losing money, and that he invested more of his capital in the business, what might be the result of his ignorance of the proper preparation of the Statement of Profit and Loss?

13

A buys $5,000.00 worth of goods from B, terms 2/10, n/30. What do these terms mean? Assuming that A pays the bill in eight days, for what amount will he make the check which he gives to B? In what two ways may A show the amount of the discount which he receives in connection with this sale on his Statement of Profit and Loss?

14

James King, retail druggist, receives $75.00 interest on his bank deposits. How should this item be shown on his Statement of Profit and Loss?

15

Name and explain the most common items of non-operating income. Name and explain the most common items of non-operating expenses. Explain why it is important that non-operating income and non-operating expenses should be recorded and reported separately from operating income and operating expenses.

LABORATORY MATERIAL

EXERCISE No. 84

On December 31, 1919, the accounts of J. B. Reynolds & Co. show the following balances:

Cash	$ 1,400.00
Notes Receivable	480.0
Accounts Receivable	9,800.00
Reserve for Bad Debts	860.00
Merchandise Inventory	10,250.00
Furniture and Fixtures	2,200.00
Reserve for Depreciation of Furn. & Fix.	440.00
Delivery Equipment	800.00
Reserve for Depreciation of Del. Equip.	160.00
Buildings	2,900.00
Reserve for Depreciation of Buildings	290.00
Land	3,800.00
Notes Payable	3,860.00
Accounts Payable	5,240.00
J. B. Reynolds, Proprietor	10,620.00
C. R. Smith, Proprietor	10,000.00
Sales	48,000.00
Purchases	32,000.00
Buying Expenses	960.00
Selling Expenses	9,600.00
Delivery Expenses	1,240.00
Administrative Expenses	4,250.00
Interest on Notes Receivable	220.00
Interest on Notes Payable	450.00
Sales Discount	1,240.00
Purchases Discount	1,680.00

Instructions: 1. Prepare a Trial Balance from these account balances.

2. The merchandise inventory on December 31, 1919, is $12,840.00. It is estimated that the loss on bad debts will be two per cent of the accounts outstanding. The depreciation on furniture and fixtures and delivery equipment is ten per cent. and on buildings five per cent. Prepare a Balance Sheet and a Statement of Profit and Loss. The partners share profits and losses equally.

EXERCISE No. 85

HARMON & PEART

Trial Balance, December 31, 1920

Cash	$ 6,350.00	
Notes Receivable	1,640.00	
Accounts Receivable	150,600.00	
Merchandise Inventory	170,450.00	
Furniture and Fixtures	3,800.00	
Reserve for Dep. of Furn. & Fix.		$ 450.00
Delivery Equipment	3,000.00	
Reserve for Depreciation of Del. Equip.		320.00
Buildings	22,000.00	
Reserve for Depreciation of Buildings		2,840.00
Land	21,000.00	
Notes Payable		70,000.00
Accounts Payable		128,000.00
J. C. Harmon, Capital		94,380.00
J. C. Harmon, Personal	1,600.00	
L. W. Peart, Capital		90,400.00
L. W. Peart, Personal	1,040.00	
Sales		650,000.00
Sales Returns	1,200.00	
Sales Allowances	920.00	
Purchases	620,000.00	
Purchases Returns		250.00
Purchases Allowances		340.00
Freight Inward	4,250.00	
Selling Expenses	12,000.00	
Delivery Expenses	2,240.00	
Administrative Expenses	14,250.00	
Discount on Sales	1,680.00	
Discount on Purchases		2,840.00
Interest Earnings		840.00
Interest Paid	2,640.00	
	$1,040,660.00	$1,040,660.00

Inventory, December 31, 1920, $118,450.00.

Depreciation of Fixed Assets: Buildings, 2%; Furniture and Fixtures, 10%; Delivery Equipment, 10%; Loss on Bad Debts 1% of accounts receivable outstanding.

Instructions: Prepare a Balance Sheet and a Statement of Profit and Loss.

CHAPTER XXII

CONSTRUCTION AND INTERPRETATION OF ACCOUNTS

Relation of the Accounts to the Reports

In the two preceding chapters the Balance Sheet and the Statement of Profit and Loss have been discussed. These two reports provide the information from which the financial condition of the business and the result of its operation during a certain period of time can be determined. The information contained in these reports is obtained in the main from the ledger accounts. At the time the reports are made there may be certain information, such as the amount of the merchandise inventory and the depreciation on the fixed assets, which does not appear in the ledger. If this, however, has not been recorded in the accounts at the time the reports are made, it is placed there shortly afterwards, so in the end the reports and the accounts agree, and the greater part of the information which the former contain is taken from the latter.

The accounts necessary to provide a considerable portion of the information contained on the Balance Sheet and the Statement of Profit and Loss illustrated in the two preceding chapters, have been discussed previously, and this discussion need not be repeated here. The purpose of the present chapter is to discuss the additional accounts which are necessary to provide the information given in these reports.

Accounts with Real Estate

Real estate is a technical term that is applied to immovable property, such as land, buildings and other improvements which make the land more valuable. The majority of mercantile firms do not own their place of business, but rent them instead. Consequently, the discussion of accounts with real estate was not given in the preliminary treatment of accounts with fixed assets. Some mercantile firms, however, and most manufacturing firms own real estate, so the accounts necessary for its record should be understood by the student.

The purchase price fixes the value of real estate, and this value does not change except in case of additional improvements and as a result of depreciation. The value should not be increased on the

records by means of an inventory or appraisal. Although the market price may have increased, the business does not intend to sell it, and it is no more valuable in the operation of the business.

A distinction should be made between the land and the buildings because the latter have certain characteristics which do not pertain to the former. For instance, the buildings are subject to depreciation due to their use in the business and their increasing age, while urban land, at least, does not depreciate in value although its market value may fluctuate. The buildings are subject to destruction by fire, storm, etc., while the land is not; so the former are subject to insurance, while the latter is not. In order to determine the proper amount of depreciation on buildings and the proper insurance which should be carried on them, it is necessary to have their value stated separately from the value of the land on which they stand. Consequently, separate accounts are kept for buildings and for land.

The Buildings Account

The purpose of the Buildings account is to show the cost of the buildings owned by the business. This cost consists of the purchase price plus the cost of improvements made on the buildings. Cost of repairs and upkeep of the buildings must not be treated as an additional charge to the Buildings account. Such expenses may be charged to a special Building Expense account, or in a small business where such an account probably would not be kept, they will be charged as an administrative expense. Since buildings are subject to depreciation, a separate Reserve for Depreciation of Buildings account must be kept.

The debits and credits to the Buildings account are as follows:

Buildings

DEBIT:	CREDIT:
With the cost of buildings purchased or new buildings erected. With the cost of any improvements applicable to the buildings which increase their value.	With the cost of any buildings sold or otherwise disposed of.

The balance of the Buildings account shows the cost value of the buildings owned by the business. It represents one of the fixed investments and is shown as a fixed asset on the Balance Sheet.

Reserve for Depreciation of Buildings Account

The purpose of the Reserve for Depreciation of Buildings account is to show the net amount of the reserve created to provide for the

decrease in value of the buildings used in the conduct of the business.

The debits and credits to this account are as follows:

Reserve for Depreciation of Buildings

DEBIT:	CREDIT:
With the difference between the cost and scrap value of the buildings discarded or destroyed. With the difference between the cost and selling price of the buildings sold.	At the close of each fiscal period with the estimated depreciation of the buildings chargeable to the current period.

The balance of this account shows the net amount of the reserve set aside for depreciation on buildings and preferably is shown on the Balance Sheet as a deduction from the cost of the buildings.

The Land Account

The purpose of the Land account is to show the cost of the land used in the conduct of the business. This cost consists of the original purchase price plus the cost of any improvements made thereon, such as grading, laying out walks, etc.

The debits and credits to this account are as follows:

Land

DEBIT:	CREDIT:
With the *cost* of land purchased, including legal expenses incident to the purchase and passing of title. With the *cost* of grading, laying out of walks and other improvements applicable to land.	With the *cost* price of land sold.

The balance of the Land account shows the cost of the land owned by the business. It is one of the fixed investments of the business and is shown on the Balance Sheet as a fixed asset.

Accounts with Proprietorship

The difference between the total assets invested in the business and the total liabilities of the business represents the proprietorship. In a sole proprietorship this amount is shown in the proprietor's Capital account. In a partnership the proprietorship is vested in the several partners and it is necessary to keep a separate Capital account with each partner in order to show his interest in the total proprietorship.

The purpose of a partner's Capital account is to show his original investment, any additions thereto, and any withdrawals therefrom. In addition to the above, at the end of the fiscal period the partner's

share of the net profit or loss for the period is carried to his Capital account and it then shows his entire financial interest in the business.

The debits and credits to a partner's Capital account are as follows:

Partner's Capital Account

DEBIT:	CREDIT:
With the withdrawals of investment. With the partner's share of the net loss for the period.	With the original investment of the partner. With additional investments. With the partner's share of the net profit for the period.

The balance of this account, if a credit, shows the partner's share of the net worth of the business, while if a debit it shows his share of the net insolvency. In the former case it is shown on the Balance Sheet as an addition to the liabilities, while in the latter it is shown as a deduction.

In addition to the Partner's Capital account it is usually necessary to keep a Partner's Personal account. The purpose of this account is to keep a record of the amounts which the partner has withdrawn during the year in anticipation of profits or against his salary allowance. It should not include withdrawals which are intended as withdrawals of the original investment, for these items are shown in the partner's Capital account. If the partnership agreement provides for the payment of salaries to the partners, the amount of such salary should be credited to the partner's Personal account and debited to the proper expense account.

The debits and credits to a Partner's Personal account are as follows:

Partner's Personal Account

DEBIT:	CREDIT:
With amounts drawn against anticipated profits or salary allowance.	With monthly salary allowance.

The balance of this account, if a credit, should be treated as an addition to the amount of the Partner's Capital account on the Balance Sheet; if a debit, as a subtraction from the Capital account.

Accounts with Merchandise

As previously explained, in a mercantile business the chief source of income is the profit arising from the sale of merchandise. In order to determine this profit it is necessary to know: first, the net returns from sales; and second, the cost of goods sold. By refer-

ence to the Statement of Profit and Loss given in the preceding chapter, it will be seen that in order to obtain the net sales it is necessary to know in addition to the gross sales, the sales returned by customers and the allowances granted to customers. By reference to the same statement it will be seen that in order to determine the cost of goods sold it is necessary to know in addition to the total purchases for the period, the purchases returned to creditors, the allowances granted on purchases by creditors, the cost of freight and drayage on goods purchased, and, finally, the inventory at the beginning and at the end of the period.

If these separate items of information are required in order to make the Statement of Profit and Loss, it should be apparent that it is necessary to have an account with each in order that the information may be available. Accordingly, the following accounts may be kept with merchandise:

1. Sales.
2. Sales Returns.
3. Sales Allowances.
4. Purchases.
5. Purchases Returns.
6. Purchases Allowances.
7. Freight In.
8. Inventory.

It will be necessary to discuss the construction and use of each of these accounts.

Sales Account

The purpose of the Sales account is to show the gross sales of merchandise. The total of the Sales account must equal the total of all invoices issued to customers. Usually in a small business only one account is kept with Sales, the total sales of the business being recorded therein. In a larger business it is often desirable to know the amount of the sales of different commodities or of different departments of the business and a separate Sales account is kept with each commodity or department. The principles governing the use of the several accounts, however, are the same as for the single account. In the present discussion it will be assumed that a commodity or departmental analysis of sales and purchases is not desired. In a future chapter the use of accounts in making such an analysis will be explained and illustrated.

The debits and credits to the Sales account are as follows:

Sales

DEBIT:	CREDIT:
With any adjustments which reduce the amounts credited to this account.	With the sales invoice price of merchandise sold.

The balance of this account shows the gross returns from sales. It is shown as the first item of income on the Statement of Profit and Loss.

Sales Returns

The purpose of the Sales Returns account is to show the amount of goods returned by customers. The reasons for such returns have been explained in the preceding chapter.

The debits and credits to this account are as follows:

Sales Returns

DEBIT:	CREDIT:
With the selling price of all merchandise returned by customers for credit.	With any adjustments which reduce the amounts charged to this account.

The balance of this account shows the amount of the merchandise returned by customers. It is shown on the Statement of Profit and Loss as a deduction from the gross sales.

Sales Allowances

The purpose of the Sales Allowances account is to show the amount of the deductions made by the customers from the invoice price because of merchandise being damaged, being of inferior grade, or for other reasons previously explained. It is necessary to note carefully the amount of this account as well as any tendency for it to increase in ratio to gross sales, for if this account is of material size it indicates that customers are not receiving satisfactory service.

The debits and credits to this account are as follows:

Sales Allowances

DEBIT:	CREDIT:
With allowances to customers because of unsuitability or fault of goods sold to them.	With any adjustments which reduce the amounts charged to this account.

The balance of this account shows the amount of the allowances granted to customers and is shown as a deduction from gross sales on the Statement of Profit and Loss.

Purchases Account

The purpose of the Purchases account is to show the cost of merchandise purchased. Only purchases of articles intended for resale are recorded in this account. Purchases of fixed assets or of miscellaneous supplies are recorded in separate accounts.

The debits and credits to the Purchases account are as follows:

Purchases

DEBIT:	CREDIT:
With the purchases invoice cost of merchandise purchased.	With any adjustments which reduce the amounts charged to this account.

The balance of this account shows the cost of goods purchased and is shown on the Statement of Profit and Loss as an item of the cost of goods sold.

Purchases Returns Account

The purpose of the Purchases Returns account is to show the amount of merchandise returned by the business to the seller because of defects or other reasons previously mentioned.

The debits and credits to this account are as follows:

Purchases Returns

DEBIT:	CREDIT:
With any adjustments which reduce the amounts credited to this account.	With the purchase price of all merchandise returned to the seller.

The balance of this account shows the amount of the purchases returned to the seller and is shown on the Statement of Profit and Loss as a deduction from the gross cost of purchases.

Purchases Allowances Account

The purpose of the Purchases Allowances account is to show the amount of the allowances granted to the business by the seller because of defects, etc., in merchandise purchased.

The debits and credits to this account are as follows:

Purchases Allowances

DEBIT:	CREDIT:
With any adjustments which reduce the amounts credited to this account.	With allowances granted to the business by the seller.

The balance of this account shows the amount of the allowance granted by the seller to the purchaser and is shown as a deduction from the invoice cost of merchandise purchased on the Statement of Profit and Loss.

Freight In Account

The purpose of the Freight In account is to show the amount paid for freight on merchandise purchased. In addition to the freight paid to the transportation company there are frequently drayage charges incurred in transporting the merchandise purchased from the railway station to the warehouse of the purchaser. These charges are frequently recorded in the same account as the freight in. If of sufficient importance they may be recorded in a separate account, usually termed *drayage* or *delivery expenses.*

Freight paid on merchandise purchased for resale is a part of the cost, and must be considered as such in determining the proper selling price or in ascertaining the cost of goods sold. In some cases the amounts paid for freight and drayage on merchandise purchased are charged directly to the Purchases account. As mistakes may occur in rendering freight bills it is better practice to keep a separate account so that adjustments may be made more readily.

Freight paid on goods purchased should be kept separate from freight paid on goods delivered to customers. The former represents a part of the cost of merchandise purchased, while the latter is either a selling expense or a deduction from sales.

The debits and credits to this account are as follows:

Freight In

DEBIT:	CREDIT:
With amounts paid for freight, express, or postage on merchandise purchased. With freight prepaid by the seller and charged on the invoice.	With any adjustments which reduce the amounts charged to this account.

The balance of this account shows the net amount paid for transportation charges on goods purchased. It is shown as an addition to the invoice cost of purchases on the Statement of Profit and Loss.

Inventory Account

In order to determine the cost of goods sold it is necessary to know the inventory at both the beginning and the end of the fiscal

period. This is obtained usually by taking a physical count of the goods in stock and determining their value at cost price unless the present market price of the goods is lower than cost, in which case the market price should be used as a basis of valuation. Since the accounting reports and the ledger accounts must be in harmony, it is necessary to construct an account which will record the value of the inventory. Although this account is not opened until the end of the fiscal period, it will be discussed at this point to show its relation to the other merchandise accounts. Since the student is already familiar with the process of closing the ledger, this should lead to no confusion.

The purpose of the Inventory account is to show the value of the merchandise on hand at the end of the fiscal period.

The debits and credits to the Inventory account are as follows:

Inventory

DEBIT:	CREDIT:
At the end of the fiscal period with the inventory as of the closing date. The Purchases account is credited at the time this account is debited.	At the end of the fiscal period with the inventory at the beginning of the period. The Purchases account is debited at the time this account is credited.

The balance of this account shows the value of the inventory of merchandise at the end of the fiscal period. It is shown as a current asset on the Balance Sheet. Both the beginning and the ending inventories are shown on the Statement of Profit and Loss in determining the cost of goods sold.

QUESTIONS FOR CLASS DISCUSSION

1

In the records of the King Manufacturing Company there is an account with Real Estate for the amount of $10,000.00. What does this account probably represent? What accounts should be set up to take its place? Why?

2

In 1910, the Jones Mercantile Company purchases a lot and building in which to conduct their business, at a cost of $10,000.00. In 1919, a conservative valuation of this property is $15,000.00. At what price should this property be shown on the Balance Sheet of the company?

The Jones Mercantile Company have their building repainted at a cost of $150.00. How should this expenditure be recorded in the records?

4

R. C. Adams, retail druggist, purchases a store in which to conduct his business, for $3,000.00. He pays the real estate agent, through whom he makes the purchase, a commission of $100.00. He also agrees to pay one-half of the cost of obtaining an abstract of this property and this amounts to $30.00. At what amount should he record the cost of this property in his accounts?

5

A. B. King and R. L. Hill, equal partners in the business of King & Hill, during the fiscal year of 1920, make a profit of $2,600.00. Explain what disposition would be made of this profit in the accounts of the business.

6

King & Hill have agreed that each partner is to receive a salary of $100.00 a month for his services. Explain how this salary should be recorded in their accounts.

7

Merchandise to the amount of $600.00 is sold to R. B. King & Co. King returns $50.00 worth of this merchandise because it was received in a damaged condition. Thirty days after the date of the sale he pays his account as provided by the terms of sale. Explain how the foregoing transactions would be recorded in the accounts.

8

Merchandise to the amount of $560.00 is purchased from Hibbard, Spencer & Bartlett Co., terms n/60. $60.00 worth of this merchandise is returned to Hibbard, Spencer & Bartlett Co. because it does not correspond with the goods ordered. The invoice is paid at the end of sixty days. Explain the entries necessary to record the foregoing transactions in the accounts.

9

An expenditure of $50.00 is incurred in connection with merchandise purchases, and an expenditure of $40.00 is incurred in connection with merchandise sales. Explain how the foregoing amounts would be recorded in the accounts and how they would be shown on the Statement of Profit and Loss.

10

The Chicago Wholesale Company have certain merchandise in stock on December 31, 1919, which cost them one dollar per unit, but is now worth $1.20 per unit. They have certain other goods in stock on the same date which cost them one dollar per unit, but which is now worth only ninety cents a unit. Explain how these goods should be valued in the inventory of the Chicago Wholesale Company.

LABORATORY MATERIAL

Exercise No. 86

On January 1, 1919, H. C. Daines purchases for cash land and building for $30,000.00. He values the building at $10,000.00 and the land at $20,000.00. He estimates that the building will be usable for ten years and have a scrap value of $2,000.00. He pays $100.00 to a real estate agent as a commission for making the purchase. On June 1, 1919, he pays $80.00 for repairs on the building. On January 1, 1920, he pays $100.00 for taxes on the land and building. On the same date he pays $150.00 for a three-year insurance policy on the building. On June 1, 1920, he sells one-half of the land (part not occupied by building) for $15,000.00.

Instructions: Set up the accounts necessary to record the foregoing transactions and enter them therein. It may be assumed that the Cash account has a debit balance of sufficient size to provide for the cash payments called for by these transactions. The expenses applicable to the building and the land should be debited to an expense account and the profit on the sale of the land credited to a special profit account.

Exercise No. 87

Gartman & Wagoner maintain but one Merchandise account and record in this account all transactions relating to the purchase and sale of merchandise. The Merchandise account of the firm for the month of December appears as follows:

Merchandise

Dec.	1	Inventory	$3,800.00	Dec.	4	Sales	$2,240.00
	3	Purchases	2,200.00		6	Returns	380.00
	5	Freight	420.00		9	Sales	1,460.00
	7	Returns	345.00		13	Sales	3,200.00
	11	Purchases	6,740.00		14	Allowances	60.00
	14	Duty	228.00		17	Sales	4,240.00
	17	Allowances	342.00		19	Allowances	86.00
	20	Purchases	8,276.00		21	Sales	6,742.00
	23	Returns	450.00		25	Allowances	46.80
	27	Drayage	182.00		27	Returns	420.00
	30	Allowances	69.00		29	Sales	346.00

Instructions: Set up the accounts which the firm should maintain and show these items properly recorded therein.

CHAPTER XXIII

CONSTRUCTION AND INTERPRETATION OF ACCOUNTS—Continued

Accounts with Operating Expenses

The nature and the amount of the operating expenses, as previously stated, are determined in the main by the size, nature and organization of the business. In turn, the nature and amount of the expenses determine to a considerable extent their classification and the accounts which are kept to record them. In deciding what accounts are to be kept for expenses it should always be remembered that although it is important to have information which will show what the expenses have been for a certain period, it is equally important to have information which will make possible plans for the reduction of the expenses during the succeeding periods.

Usually the operations of a business are capable of a more or less definite classification. For instance, the operations of a mercantile business may be classified as follows: purchasing of goods; selling of goods; transporting and delivery of goods; and administering of the business as a whole. Of course, each of the above classes of operations is capable of considerable subdivision, but the above indicates fairly well those of a medium-sized business.

In connection with each class of business certain expenses are incurred, and in judging past results and making future plans, it is desirable to have the expenses classified accordingly. Thus the expenses of a mercantile business may be classified as follows:

1. Buying Expenses.
2. Selling Expenses.
3. Drayage and Delivery Expenses.
4. Administrative Expenses.

If such a classification exists there must be at least one account with each class. Of course, several accounts may be kept with each of these subdivisions. For the sake of simplicity it will be assumed for the present that only one account will be kept with each class of expense. The more detailed accounts will be introduced later.

Buying Expenses

The purpose of the Buying Expenses account is to show the expenses incurred in the purchase of merchandise. In a store which

does not have one or more buyers to devote their entire time to the purchase of merchandise, this function may be performed by the owner, manager or other executive of the business. In this case the proportionate part of the salary of the person who performs the duties of the buyer should be treated as a buying expense. Similarly, the estimated number of hours a week given by any member or members of the office force to buying should be charged to this account. This account should also be charged with traveling expenses of buying trips and other miscellaneous buying expenses.

The debits and credits to this account are as follows:

Buying Expenses

DEBIT:	CREDIT:
With all expenses incurred in the purchase of merchandise.	With any adjustments which reduce the amounts debited to this account.

The balance of this account shows the expenses incurred in the purchase of merchandise and is shown on the Statement of Profit and Loss as an operating expense.

Selling Expenses

The purpose of the Selling Expenses account is to show the expenses incurred in the sale of merchandise. The wages and other remunerations of sales persons, order-takers, and all others engaged in selling should be treated as selling expense. If it is the duty of some executive to supervise the sales department of the business, his salary should also be charged to this account. Expenditures for advertising purposes, such as space in the newspapers, periodicals, space on the street cars and billboards, circulars and postage thereon, advertising novelties, charitable donations, window display, etc., should be treated as part of selling expense. Such expenses may be charged to an advertising account, but if so, they should be added to the other selling expenses in arriving at the total sales expense of the business. In addition to the above, the cost of wrapping paper, cartons, twine, salesmen's order books, and all other items of direct selling expense should be charged to this account.

The debits and credits to this accounts are as follows:

Selling Expenses

DEBIT:	CREDIT:
All expenses incurred in connection with the sales of merchandise.	With any adjustments which reduce the amounts debited to this account.

The balance of this account shows the expenses incurred in the sale of merchandise and is shown on the Statement of Profit and Loss as an operating expense.

Accounts with Delivery and Drayage Expense

In every mercantile business there are certain expenses incurred in connection with the local transportation of merchandise. In a retail business the goods purchased must be transported from the railroad depot to the warehouse of the business. Such transportation may be performed by the business itself or it may employ others to do it. In either case expenses are incurred. These expenses—usually known as drayage—constitute a part of the cost of the merchandise and are added to the invoice price in arriving at the cost of the goods sold.

In addition, the retail business usually incurs certain expenses in connection with the delivery of goods sold to customers. This expenditure constitutes an operating expense and may be shown on the accounting reports as a separate item or as a subdivision of selling expense.

In a wholesale business certain expenses are incurred in connection with the transporting of merchandise from the railroad depot to the warehouse of the business. As in the case of the retail business, these expenses—known as drayage expenses—constitute a part of the cost of the goods purchased. The wholesale company also incurs expenses in connection with the transporting of goods sold from its warehouse to the railroad depot. As in the case of the delivery expenses in the retail business, these expenses—by whatever name known—constitute a selling expense. Sometimes the wholesale company uses the same equipment to deliver goods to the depot and bring goods from the depot. In this case it may be impracticable to attempt to keep the cost of these two services separately. In this case the total cost is recorded in one account and at the end of the period it is allocated on some rational basis as between the cost of goods purchased and selling expense.

In the following discussion the term *delivery expense* will be used to refer to the cost of delivering goods sold, whether these goods are delivered directly to the purchaser, as in the case of the retail business, or only to the railroad depot, as in the case of the wholesale business.

The purpose of the Delivery Expenses account is to show the cost of delivering merchandise to customers. Wages of employes engaged in delivering the goods, as well as wages of any employes

engaged to assist with this work, should be treated as delivery expense. In addition, all stable and garage expenses, also all repairs, taxes, licenses, upkeep, and depreciation on delivery equipment should be charged to this account.

The debits and credits to this account are as follows:

Delivery Expenses

DEBIT:	CREDIT:
With expenses incurred in connection with the delivery of merchandise.	With any adjustments which reduce the amounts debited to this account.

The balance of this account shows the cost of delivering merchandise to customers and may be shown on the Statement of Profit and Loss as a separate item under operating expense, or it may be shown as a sub-item under selling expense.

Administrative Expenses

The purpose of the Administrative Expenses account is to show expenses incurred in the administration and management of the business. The various items of expense which may be charged to this account are too numerous to mention. Some of the most important, however, are salaries of the manager, bookkeepers, office clerks, stenographers, and general office help not otherwise charged; the cost of stationery of all sorts, account books, forms, typewriter supplies, printing, postage, and depreciation on office equipment, the expenses of insurance on stock and store equipment as well as taxes on the same, the cost of heat, light, repairs, depreciation on store equipment, and other miscellaneous items are usually charged to administrative expenses.

The debits and credits to this account are as follows:

Administrative Expenses

DEBIT:	CREDIT:
With all expenses incurred in connection with the administration and management of the business.	With any adjustments which reduce the amounts debited to this account.

The balance of this account shows the cost of the administration and management of the business and is shown as an operating expense on the Statement of Profit and Loss.

Non-Operating Income and Expenses

In addition to the operating income which the business receives through the sale of its merchandise it frequently receives some non-operating income from miscellaneous sources. The principal items of such income are interest and sales discount. In the same man-

ner every business, in addition to such operating expenses as are discussed in the foregoing paragraphs, incurs certain non-operating expenses. Interest paid and sales discount are two expenses of this kind which occur frequently. The accounts necessary to record these items of non-operating income and non-operating expense will be discussed in the following paragraphs.

Interest

Interest may be defined as the charge made for the use of money. A business is often required to borrow money from the bank in order to finance its operations. In return for the use of this money, the business is required to pay the bank a certain amount which is usually stated as a certain per cent. of the amount borrowed. For instance, if $100.00 is borrowed for one year at the rate of six per cent. interest, there will be due at the end of the year $106.00, representing the $100.00 originally borrowed which is known as the principal and $6.00 which is compensation for the use of $100.00 for one year, and is known as interest. It will be noticed that the $6.00 is paid for the use of the $100.00 for one year. If it is not used for one year, but only for a part thereof, the amount of interest is reduced proportionately. For instance, if the $100.00 is borrowed at six per cent. for six months, the interest will be $3.00 and if for three months $1.50.

In most businesses the principal transactions with interest are those between the business and the bank from which money is borrowed. However, notes may be given by the business to creditors on which interest is paid and notes may be received from customers on which interest is received. It will be seen, therefore, that from the viewpoint of a particular business, interest may be classified as interest paid and interest received. By referring to the Statement of Profit and Loss given in a previous chapter, it will be seen that interest is so classified on this report. The interest received being shown as an item of non-operating income and interest paid as an item of non-operating expense. It will be necessary, therefore, to have two accounts with interest: one showing the interest paid; the other, the interest received.

Interest Paid Account

The purpose of the Interest Paid account is to show the amount paid to those from whom money is borrowed for the use of the money borrowed or owed by the business.

The debits and credits to this account are as follows:

Interest Paid

DEBIT:	CREDIT:
With all amounts paid as interest.	With any adjustments which reduce the amounts debited to this account.

The balance of this account shows the total amount paid as interest and is shown on the Statement of Profit and Loss as a non-operating expense under the heading of "Deductions from Income."

Interest Received Account

The purpose of the Interest Received account is to show the amount received from others in return for money loaned them or owed by them.

The debits and credits to this account are as follows:

Interest Received

DEBIT:	CREDIT:
With any adjustments which reduce the amounts credited to this account.	With all amounts received as interest.

The balance of this account shows the amount of interest received by the business and is shown as a non-operating income on the Statement of Profit and Loss under the heading of "Other Income."

Sometimes interest is paid or collected in advance. For instance, if Brown & Smith desire to borrow money from the bank, they may execute a note to the bank by which they promise to pay $500.00 in two months. If the rate of interest on which they and the bank agree is six per cent., the bank may calculate the interest on $500.00 for two months, which amounts to $5.00, and subtract this from the face of the note for $500.00 and give Brown & Smith the remainder, or $495.00. In this case, interest has been paid in advance, since the bank received a $500.00 note from Brown & Smith and gave them in return for it but $495.00. Interest paid in advance is sometimes known as discount and may be shown in a separate account by that name. It is interest just the same as if it were not paid until the note were due. So it seems that little purpose is served by recording it in a separate account.

Sometimes business firms, when in need of funds, discount at the bank notes which they have received from their customers. Notes received from customers may or may not bear interest. When a note bears interest, the process of discounting and of making a record thereof is a little more complex than if it is non-interest bearing. The method to be followed in each case will be illustrated.

G. B. Jones receives from W. V. Lindblom a ninety-day non-interest bearing note for $600.00. At the end of thirty days Jones needs additional funds and discounts this note at his bank. The bank must wait sixty days to obtain the face of the note, or $600.00. Consequently it will charge Jones interest on the face of the note for sixty days. If it is assumed that the discount rate is six per cent., the interest for sixty days is $6.00, and in accordance with this the bank will deduct $6.00 from the face of the note and give Jones credit for $594.00. This has the same result as if the bank had paid Jones $600.00 and he had paid it $6.00. Consequently there will be two entries made for the transaction. In the cash receipts journal or the debit side of the cash book, Cash will be debited and Notes Receivable credited. In the cash disbursements journal or the credit side of the cash book, Interest Paid will be debited and Cash credited.

If the note which Jones receives from Lindblom bears interest at the rate of six per cent, and he discounts it with the bank under the same conditions stated in the previous paragraph, it is plain that the bank will receive at the date of maturing the face of the note $600.00, plus the interest for 90 days, $9.00, or a total of $609.00. Since it must wait sixty days to obtain this amount, it will deduct interest for this length of time. If the discount rate is six per cent., the interest on $609.00 for sixty days is $6.09. Subtracting this from the value of the note at maturity, the proceeds or the amount which the bank will pay Jones for the note is $602.91. In recording this transaction, it is necessary to make the following entries in the cash receipts journal, or the debit side of the cash book:

		Notes Receivable	Discounted W. V. Lindblom note	600	00
		Interest Received	On discounted note of W. V. L.	9	00

In the cash disbursements journal, or the credit side of the cash book, the following entry will be made:

		Interest Paid	Discount on note of W. V. L.	6	09

When these entries are posted, the net result on the Cash account will be an addition of $602.91, which is the net proceeds of the note.

If a bank deducts the interest in advance on the note of the firm which borrows on its own note, it is necessary to make two entries. In the cash receipts journal, or the debit side of the cash book, Cash

is debited and Notes Payable credited. In the cash disbursements journal, or the credit side of the cash book, Interest Paid is debited and Cash credited.

The rate of interest charged is a matter of considerable importance and varies somewhat between localities and at different times in the same locality. To prevent unreasonable charges for the use of money, most of the states have enacted laws fixing the rate that may be collected. This is termed the *legal* rate. Some states provide that a higher rate than the legal rate may be collected if mentioned in the contract. This is termed the *contract* rate. These rates vary from state to state and the student must consult the laws of his own state in order to determine what they are.

Accounts with Merchandise Discount

It is a business custom to offer a discount or deduction on the invoice price on many lines of merchandise for the prompt payment of the obligation incurred by its purchase. For instance, H. G. Gooch & Co. may sell $1,000.00 of merchandise to H. L. Cohagen & Co. with the agreement that payment is to be made within thirty days, but that two per cent may be deducted from the face of the invoice if payment is made within ten days. Consequently, if H. L. Cohagen & Co. pay H. G. Gooch & Co. $980.00 within ten days, the obligation is satisfied. The $20.00 deduction from the invoice price allowed for prompt payment is termed *merchandise discount.* Discount is indicated usually on the invoice, being shown in abbreviated form. In the above illustration the discount may be shown thus: 2/10, n/30. This indicates that a discount of two per cent will be allowed for payment within ten days, and if it is not paid within that time, the invoice is "net"; that is, that the total amount of the invoice, is to be paid within thirty days.

As previously stated, there is a difference of opinion as to the nature of merchandise discount and as to how it should be shown on the reports, but it is not advisable to enter into this controversy here. For the present, discount on purchases will be regarded as *other income* and discount on sales will be regarded as a *deduction from income.*

Although discount on purchases and discount on sales are both termed *merchandise discount* they should not be recorded in the same account, as is sometimes done. If they are recorded in one account and the difference between the two shown on the Statement of Profit and Loss, statistics of importance are concealed. The total amount saved by taking discount on purchases is not shown;

neither is the nature of the trade customers as indicated by the discount taken on sales. To know the excess of sales discount over purchases discount, or vice versa, really means nothing. It is the separate statistics which are valuable. Consequently, two accounts, termed Purchases Discount and Sales Discount accounts, should be kept.

Purchases Discount Account

The purpose of the Purchases Discount account is to show the total deductions allowed for prompt payment of obligations owed by the business. These deductions are made according to the terms on the invoices.

The debits and credits to this account are as follows:

Purchases Discount

DEBIT:	CREDIT:
With any adjustments which reduce the amounts credited to this account.	With all cash discounts taken in accordance with the terms offered by creditors.

The balance of this account is the total cash discounts on purchases and is shown on the Statement of Profit and Loss as a non-operating income under the heading of "Other Income."

Sales Discount Account

The purpose of the Sales Discount account is to show the total deductions made by customers for prompt payment of invoices. These deductions are governed by the agreement between the purchaser and the seller as shown by the terms on the invoice.

The debits and credits to this account are as follows:

Sales Discount

DEBIT:	CREDIT:
With all discount taken by customers within the terms of the invoices rendered them.	With any adjustments which reduce the amounts debited to this account.

The balance of this account is the total cash discounts on sales and is shown on the Statement of Profit and Loss as a non-operating expense under the heading of "Deductions from Income."

QUESTIONS FOR CLASS DISCUSSION

1

You are requested by the James Mercantile Company to prepare a list of the accounts which the company should maintain with operating expenses. What information would you desire to obtain before preparing this list?

2

What are the principal operations of a mercantile store? What effect do the operations which it performs have on its operating expense accounts?

3

Mr. Wiel makes a trip to Chicago to buy goods for his store. How should the expenses of this trip be recorded in the records of Mr. Wiel?

4

Give ten items of expense which may be treated as selling expenses.

5

The Hodge Dry Goods Co. have certain delivery equipment which they employ principally in delivering merchandise to customers. They also use the same equipment to some extent in hauling merchandise purchased from the railroad depot to its warehouse. All expenses in connection with the delivery equipment, as well as the wages of the drivers, are charged to the Delivery Expense account. At the end of the fiscal period this account shows a balance of $3,600.00. It is estimated that one-tenth of this expense was incurred in connection with merchandise purchased. Explain the entries which should be made in connection with this account at the end of the fiscal period and also explain how this expense should be shown on the Statement of Profit and Loss.

6

State the principal items of expense which should be treated as administrative expenses.

7

At the end of the fiscal period it is estimated that delivery equipment has depreciated $100.00 and that the store building has depreciated $500.00. Explain how these items should be shown in the accounts and on the reports.

8

Explain and illustrate the meaning of non-operating income and non-operating expense.

9

Give two illustrations of each of the above which occur frequently and give a transaction from which each would result.

10

James King borrows $500.00 from his bank for six months with interest at six per cent., payable at the end of the six months. Explain the entries which would be made on King's records at the time the loan is secured and at the time of payment.

11

Assume that in the foregoing case King *discounts* at six per cent his six-month note for $500.00, and pays the bank $500.00 in settlement thereof at the end of the six months. Give the entries to be made on King's records at the time the note is discounted and at the time of payment.

12

James Arnold purchases $600.00 of merchandise, terms net 30 days. At the end of the 30 days in order to obtain an extension of time he gives the business his 60-day note with interest at six per cent. At the end of the 60 days he pays the note and interest. Give the entries required at the time of the sale, when the note is received and when the note and interest are paid.

13

Explain and illustrate the meaning in connection with interest of the *legal* rate and of the *contract* rate. What is the legal rate and the contract rate in your state?

14

A sale of $600.00 of merchandise is made to H. B. Harvey, terms 2/10, n/30. Harvey pays his account within the discount period. Give the entries necessary at the time of the sale and at the time of the payment.

15

$800.00 of merchandise is purchased from R. L. Todd, terms 1/10, n/30. Payment is made within the discount period. Give the entries necessary to record the purchase and the payment.

LABORATORY MATERIAL

Exercise No. 88

The expenses of C. M. Wells, retail merchant, during the month of April, as shown by his check stubs, are as follows:

1.	Salaries of sales clerks	$100.00
2.	Salary of stenographer	15.00
3.	Office boy	6.00
4.	Repairs on delivery truck	14.00
	Gasoline for delivery truck	2.80
6.	Repairs on typewriter	1.60
7.	Repairs on adding machine	3.40
8.	Expenses of Mr. Wells on buying trip	68.70
9.	Telephone bill	6.80
10.	Telegrams for purchasing goods	6.40
11.	Gasoline for delivery truck	3.40
	Repairs on office furniture and fixtures	1.40
13.	Salaries of sales clerks	200.00
14.	Salary of delivery man	32.00
15.	Gasoline for delivery truck	2.70
16.	Advertising circulars	40.00
17.	Paid for distributing circulars	8.00
18.	Salary of stenographer	15.00
	Janitor	15.00
20.	Errand boy (Sales Dept.)	1.20
21.	Light for store	3.90
22.	Commissions of sales clerks	120.00
23.	Gasoline for delivery truck	2.90
24.	Salaries of sales clerks	200.00
25.	Delivery man	32.00
	Office boy	12.00
27.	Rent	100.00

Instructions: Open the following accounts: (a) Buying Expense, (b) Selling Expense, (c) Delivery Expense, and (d) Administrative Expense.

Record the expenses of Wells in these accounts. All credits will be to the Cash account and it may be assumed that there is a sufficient cash balance to meet these expenditures. Cash account not required.

Exercise No. 89

W. C. Eaton operates a small general merchandise store. He has only one Operating Expense account. The following is a copy of this account for the first eight days of May:

Expenses

May	1	Sales Salaries	$25.00				
		Errand Boy	5.00				
		Repairs to Delivery Wagon	8.00				
	2	Interest Paid on Note due to X. National Bank	7.00				
		Janitor	15.00				
		Rent for Month	80.00				
	3	Newspaper Advt.	8.00				
		Traveling Expenses to Chicago to Buy Goods	10.00				
		Interest Paid on Note Payable to W. C. May	4.00				
	4	Repairs on Furn. & Fix.	6.00				
	5	Handbills Printed	4.60				
		Paid Boys to Distribute Handbills	1.90				
	6	Sales Salaries	25.00				
		Errand Boy	5.00				
		Stenographer	12.00				
		Interest on Note Payable to C. W. Banks	5.60				
		Light Bill	2.80				
		Gas Bill	4.20				
	8	Repairs on Typewriter	.75				
		Stationery for Office	8.60				
		Veterinary Bill for Sick Delivery Horse	5.40				

Instructions: 1. Open the accounts which Mr. Eaton should maintain to record the transactions now recorded in the one account.

2. Record the items given in foregoing account in the proper accounts.

Exercise No. 90

The following are a part of the transactions of J. M. Clark for the month of May; terms on sales of merchandise 1/10, n/60.

May 1. Invests $10,000.00 in cash.

Purchases lot and building for $6,000.00 (lot $2,000.00, building $4,000.00).

2. Purchases furniture and fixtures for cash, $595.00.

Pays for drayage on furniture and fixtures, $5.00.

3. Pays for repairs to building, $150.00.

May 4. Purchases from Jones & Co., merchandise, \$600.00, terms 2/10, n/30.

5. Purchases from King & Co., merchandise, \$840.00, terms 1/10, n/60.

Returns to Jones & Co., damaged merchandise, \$20.00.

7. Sells to Cline & Elliott, merchandise, \$400.00.

8. Pays for construction of an additional room to building to be used as a warehouse, \$800.00.

10. Pays American Railway Co., for freight on merchandise purchased, \$98.00.

11. Cline & Elliott return \$20.00 goods shipped on 7th.

12. Sells Jones & Torr, merchandise, \$450.00.

Pays Jones & Co., for invoice of May 4th, less discount.

Purchases from Hill Mfg. Company, merchandise, \$1,600.00, terms 2/10, n/30.

14. Pays King & Co., for invoice of 5th, less discount.

15. Pays freight on purchases, \$22.00.

16. Sells the McGee Mercantile Co., merchandise, \$700.00.

17. Receives from Cline & Elliott payment of invoice of May 7th, less discount.

18. Grants to Jones & Torr an allowance of \$12.00 because of defects found in goods shipped them on May 12th.

22. Purchases merchandise from King & Co., \$1;240.00, terms 1/10, n/60.

Receives from Jones & Torr payment of invoice of May 12th, less discount.

Pays Hill Mfg. Co. invoice of 12th, less discount.

24. Pays freight on purchases, \$42.00.

26. Receives from McGee Mercantile Co. payment of invoice of May 16th, less discount.

Sells Cline & Elliott, merchandise, \$1,600.00.

28. Purchases from Jones & Co., merchandise, \$1,340.00, terms 1/10, n/60.

29. Pays freight on purchases, \$32.00.

30. Jones & Co. grant an allowance of \$21.00 because of defective goods received in the purchase of May 28th.

Instructions: 1. Construct the accounts necessary to record these transactions.

2. Take a Trial Balance.

CHAPTER XXIV

CONTROLLING ACCOUNTS

Purpose of Controlling Accounts

In a mercantile business there are a great many transactions with sales and purchases. Most of these sales and purchases are on account, and in order to keep a record of the amount due from customers and due to creditors it is the usual practice to have an account with each person or firm from whom goods have been purchased or to whom goods have been sold. If these individual accounts with customers and creditors are placed in the general ledger the majority of the accounts which it contains are with creditors and customers. In order to provide for the payment of creditors and the collections from customers these separate accounts are necessary, but from the viewpoint of the accounting reports it is only the total due that is of importance. Consequently, it is customary to show accounts receivable and payable as totals on the Balance Sheet and similar reports.

The Trial Balance, however, is a summary of the debits and credits of all the ledger accounts, so if individual accounts with customers and creditors are kept in the ledger it is necessary to list each of these on the Trial Balance. This is apt to make the Trial Balance exceedingly lengthy and, since there are very frequent and numerous postings to these accounts, errors are apt to be made which will prevent the obtaining of the Trial Balance. In order to eliminate these difficulties it is customary to set up on the ledger an Accounts Receivable account, which shows the total due from customers, and an Accounts Payable account, which shows the total due to creditors, and to keep in a separate ledger the accounts with the individual customers and creditors. The balance of the account in the general ledger must, of course, always equal the sum of the balances of all the individual accounts kept in the separate or subsidiary ledger. On the Trial Balance only the totals as shown by the accounts in the general ledger are used.

Accounts like the Accounts Receivable and Accounts Payable accounts, as above explained, are known as *controlling* accounts. A controlling account may be said to be an account which shows in total what is shown in detail in other accounts. It is the purpose

of this chapter to explain the use of the Accounts Receivable and Accounts Payable accounts as controlling accounts.

The Accounts with Customers

All sales for which it is desired to debit customers' accounts are recorded in the sales journal. In some businesses this includes all sales, but in a retail business cash sales may be recorded in the cash book only. If a controlling account is not kept with accounts receivable, when the sales journal is posted each customer is debited for the amount of his purchase and the Sales account is credited for the total. To illustrate this method it may be assumed that John Brown, wholesale merchant, has made the following sales:

May 1.	James Arnold, 2/10, n/30	$340.00
2.	Henry James, 1/10, n/30	285.00
3.	B. A. Griswold, 1/20, n/60	385.00
4.	H. P. King, 1/10, n/60	460.00
5.	J. W. Baker, 1/20, n/60	760.00
6.	L. S. Lyon, 1/10, n/30	540.00
7.	G. B. Crawford, 2/10, n/30	438.00
	M. B. Long, n/30	370.00

These transactions may be recorded in a sales journal as follows:

May, 192

Date		L. F.	Name	Address	Terms	Inv. No.	Amount	
	1		James Arnold	St. Louis, Mo.	2/10, n/30	1	340	00
	2		Henry James	New York	1/10, n/30	2	285	00
	3		B. A. Griswold	Fork Smith, Ark.	1/20, n/60	3	385	00
	4		H. P. King	Kansas City, Mo.	1/10, n/60	4	460	00
	5		J. W. Baker	Cincinnati, O.	1/20, n/60	5	760	00
	6		L. S. Lyon	Chicago, Ill.	1/10, n/30	6	540	00
	7		G. B. Crawford	Kansas City, Mo.	2/10, n/30	7	438	00
			M. B. Long	Wichita, Kan.	n/30	8	370	00
			Sales Credit				3,578	00

When these entries are posted, the ledger accounts affected thereby will appear as follows:

James Arnold

May	1			340	00						

Henry James

May	2			285	00						

B. A. Griswold

May	3			385	00						

H. P. King

May	4			460	00						

J. W. Baker

May	5			760	00						

L. S. Lyon

May	6			540	00						

G. B. Crawford

May	7			438	00						

M. B. Long

May	8			370	00						

Sales

						May	8			3,578	00

If the above method is followed, it will be necessary when the Trial Balance is taken to list each of the customers' accounts separately thereon. When the Balance Sheet is made it will be necessary to add all the individual items appearing on the Trial Balance in order to obtain the total of accounts receivable. If, however, a controlling account with Accounts Receivable is opened in the ledger, the total due from customers as shown by the sales journal will be debited to the Accounts Receivable account at the time that the Sales account is credited. In the above example the accounts on the main ledger would appear as follows:

Accounts Receivable

May	8			3,578	00						

Sales

						May	8			3,578	00

Thus, it will be necessary to place on the Trial Balance but the one item of accounts receivable which will represent the total due from all customers. Of course, a separate account with each customer will be maintained in a subsidiary ledger known as the *customers'* or *sales ledger.* The individual items shown in the sales journal will be posted to this ledger, but this posting will have no effect on the main ledger or the accounting reports.

From the above illustration it can be seen how the controlling account with Accounts Receivable can be made to show the total due from customers by debiting it with the total of the sales recorded in the sales journal. It will be realized, however, that payments are made by customers which reduce the amount which they owe and that these payments must be credited to the Accounts Receivable account and to the customers' individual accounts in order that these accounts may show the balance due. The money received from customers to apply on account is entered on the debit side of the cash book, and a separate entry is made for each such receipt. When the cash book is posted, it is necessary to post each separate item to the credit of the customer from whom received. It is also possible to post each item separately to the credit of the controlling account with Accounts Receivable. This, however, would necessitate the posting of each entry with cash received from customers twice—once to the customers' ledger and once to the controlling account in the main ledger. In order to eliminate this double posting it is customary to construct a cash book which will make possible the posting of the amount received from customers as a total to the credit of the controlling account. Since cash received from various sources is recorded on the debit side of the cash book, it is necessary to have a separate column in which to record cash received from customers to apply on account in order to make possible the posting of these amounts as a total. The form of such a cash book and the method of recording a few typical transactions will be illustrated.

It may be assumed that certain of the customers whose purchases are recorded in the sales journal given on page 322, have paid as follows:

May 11.	James Arnold, invoice 5/1	$333.20
12.	Henry James, invoice 5/2	282.15
14.	H. P. King, invoice 5/4	455.40
16.	L. S. Lyon, invoice 5/6	534.60

It will be noticed that the discount has been deducted in each case; consequently, the amount received is less than the face of the

invoice. On the debit side of the cash book these transactions may be recorded as follows:

Cash Receipts

Date		L. F.	Accounts Credited	Explanation	Accounts Receivable Cr.	Sales Discount Dr.	General
192							
May	11		James Arnold	Inv. 5/1, less 2%	340 00	6 80	333 20
	12		Henry James	Inv. 5/2, less 1%	285 00	2 85	282 15
	14		H. P. King	Inv. 5/4, less 1%	460 00	4 60	455 40
	16		L. S. Lyon	Inv. 5/6, less 1%	540 00	5 40	534 60
			Accounts Receivable, Cr.		1,625 00		
			Sales Discount, Dr.			19 65	
			Cash, Dr.				1,605 35

When the totals indicated above are posted, the accounts in the main ledger will appear as follows:

Accounts Receivable

May	8			3,578 00	May	16			1,625 00

Sales Discount

May	16			19 65					

Cash

May	16			1,605 35					

In addition to the posting of the totals to the main ledger it is necessary to post the individual items to the customers' ledger. The accounts of the customers to whom sales were made as shown by the sales journal on page 322, will then appear as follows:

James Arnold

May	1			340 00	May	11			340 00

Henry James

May	2			285 00	May	12			285 00

B. A. Griswold

May	3			385 00					

H. P. King

May	4			460	00	May	14		460	00

J. W. Baker

May	5			760	00					

L. S. Lyon

May	6			540	00	May	16		540	00

G. B. Crawford

May	7			438	00					

M. B. Long

May	8			370	00					

The customers now owing the business are as follows:

B. A. Griswold	$ 385.00
J. W. Baker	760.00
G. B. Crawford	438.00
M. B. Long	370.00
Total	$1,953.00

It can be readily seen by comparison that this total of the balances due from individual customers as shown in the customers' ledger is equal to the balance of the Accounts Receivable account as shown in the main ledger.

The Accounts with Creditors

The principles governing the use of the controlling account and the individual accounts with creditors are the same as those discussed above in connection with the controlling account and subsidiary accounts with customers. The total due creditors as shown by the purchases journal is credited to the Accounts Payable account in the main ledger, while the amount due each creditor is posted individually from the purchases journal to the creditors' or purchases ledger. The amounts paid creditors on account are

entered on the credit side of the cash book. The following is an illustration of the form of such a cash record and the method of recording such transactions in it:

Cash Payments

Date		L. F.	Accounts Debited	Explanation	Accounts Payable Dr.	Pur. Disc't Cr.	General
192							
May	11		A. C. Hodge	Inv. 5/1, less 2%	640 00	12 80	627 20
	15		N. W. Barnes	Inv. 5/5, less 1%	500 00	5 00	495 00
	16		W. H. Spencer	Inv. 5/6, less 2%	800 00	16 00	784 00
	18		H. G. Moulton	Inv. 4/28, less 2%	320 00	6 40	313 60
	20		W. E. Atkins	Inv. 4/29, less 1%	336 00	3 36	332 64
			Accounts Payable, Dr.		2,596 00		
			Purchases Discount, Cr.			43 56	
			Cash, Cr.				2,552 44

The posting of the totals of each of the columns in the above cash record is shown in the summary at the bottom of the illustration. The individual items are posted separately to the debit of the creditors' accounts in the creditors' ledger. After the purchase journal and the credit side of the cash record have been posted, the sum of the balances of the creditors' accounts in the creditors' ledger will equal the balance of the Accounts Payable account in the general ledger.

Miscellaneous Transactions Affecting the Accounts Receivable and Accounts Payable Accounts

In the foregoing discussion it has been explained that the Accounts Receivable account is debited from the sales journal for the amounts due from customers and credited through the cash book for their payments, while the Accounts Payable account is credited through the purchases journal for the amount due creditors and debited through the cash book for the amount paid them. The principal debits and credits to these accounts come from the sources above mentioned, but occasionally there are transactions affecting these accounts which can not be entered in the records mentioned. For instance, a customer may return merchandise which he has purchased on account or he may be granted an allowance from the sales price. This transaction affects both the Accounts Receivable account in the general ledger and the individual account of the customer in the customers' ledger. Such transactions are usually recorded in the journal and the credit posted individually to both

the general ledger and the sales ledger. For instance, if C. O. Hardy returns $25.00 worth of merchandise and receives credit therefor, a journal entry will be made as follows:

Sales Returns	$25.00	
C. O. Hardy		$25.00

The credit item of $25.00 will be posted to the Accounts Receivable account in the general ledger and also to C. O. Hardy's account in the customers' ledger.

If such transactions are numerous a separate column may be provided for them in the journal so the credit to Accounts Receivable account may be made as a total, or if they are very frequent a separate journal termed a sales returned journal may be used to record them.

In the same manner that customers may return goods or claim an allowance from the sales price, goods purchased may be returned to creditors or an allowance claimed from the purchase price. For instance, $30.00 worth of goods may be returned for credit to Jacob Viner, a creditor. The entry would be made in the journal as follows:

Jacob Viner	$30.00	
Purchases Returns		$30.00

The debit item would be posted to both the Accounts Payable account in the general ledger and to Viner's account in the creditors' ledger. If such transactions are frequent a separate column in the general journal may be assigned to them or a separate journal, called a returned purchases journal, may be used to record them. For the present the general journal will be used to record these miscellaneous transactions with both sales and purchases.

It has been explained in the foregoing paragraphs that cash received from customers to apply on account is entered in the cash book and posted from this record to the controlling account and the individual accounts of the customers. Sometimes customers give notes in settlement of their open accounts instead of paying cash. The note, in fact, does not pay their debt, but it changes the form of this indebtedness from an oral promise to a written promise, and this change must be indicated in the records, for on the Balance Sheet customers' oral promises are recorded as *accounts* receivable and their written promises as *notes* receivable. Therefore

a record of each note received from a customer to apply on account is made in the journal. For example, if C. O. Colby gives the business a note for $150.00 in payment of his account, it would be entered in the journal as follows:

Notes Receivable	$150.00	
C. O. Colby		$150.00

The credit item would be posted to the Accounts Receivable account in the general ledger and to the account of C. O. Colby in the customers' ledger. If such items are numerous, a separate column in the journal may be used to record them or they may be recorded in a separate journal called a notes journal.

In the same manner that notes are received from customers in payment of their accounts, notes may be given to creditors in payment of the amount due them. In this case a record must be made in the journal debiting the creditor and crediting Notes Payable. If a note for $300.00 is given to J. P. Hinkle to apply on account, the journal entry would be:

J. P. Hinkle	$300.00	
Notes Payable		$300.00

The debit item will be posted to the Accounts Payable account in the general ledger and to the account of Hinkle in the creditors' ledger. If such accounts are sufficiently frequent a separate column in the journal or a separate journal may be used to record them.

Proving the Customers' and Creditors' Ledgers

As suggested in the foregoing discussion, the total of the balances of the customers' accounts, as shown by the customers' ledger, should equal the balance of the Accounts Receivable account in the general ledger. In order to test this equality at the time the Trial Balance is made, a list of the balances of the customers' accounts is made and the total thereof compared with the balance of the controlling account. Similarly, the total of the balances of the creditors' accounts, as shown in the creditors' ledger, should equal the balance of the Accounts Payable account in the general ledger, and this equality is tested in the same manner when the Trial Balance is made.

Advantages of Controlling Accounts

The principal advantages derived from the use of the controlling accounts discussed above are:

1. The Trial Balance is greatly shortened, thus making it more useful as a report.
2. The Trial Balance can be obtained without reference to the individual postings to the various individual accounts and consequently the chance for errors is greatly minimized. If errors are made in posting to the individual accounts, these can be found later, after the Trial Balance of the general ledger is obtained.
3. By means of the controlling accounts the total due from customers or to creditors can be easily determined at any time.
4. There are usually a great many accounts with customers and creditors and the recording of these in separate ledgers makes it possible for several bookkeepers to post to these accounts at one time, which would be impossible if they were all in one record.
5. Usually it is desirable to post to personal accounts daily, while the posting to the general ledger is made only at the time of a Trial Balance. This frequent posting is facilitated by the use of the separate ledgers.

Other Controlling Accounts

There are other controlling accounts than those discussed in this chapter which are used in modern accounting practice, but the two given are those most frequently used and for which there is an urgent need in every business of appreciable size. Other controlling accounts which may be used under different circumstances will be discussed in a future chapter.

QUESTIONS FOR CLASS DISCUSSION

1

The Arnold Wholesale Company make sales on account to approximately 3,000 customers. They purchase goods on account from approximately 400 creditors. They have attempted to keep a separate account with each customer and each creditor in their ledger. They find that this makes the ledger cumbersome and causes considerable difficulty in the making of the Trial Balance. Explain a method which they might employ to eliminate these difficulties.

2

Explain any other advantages which the company might derive from the method which you suggest.

3

Explain to the bookkeeper of the Arnold Wholesale Company the proper method of posting his sales journal under the method which you outlined in the answer to Question 1.

4

The Arnold Wholesale Company have hitherto had a cash record in which all cash receipts were recorded in one column. What effect will the method of recording purchase and sales outlined by the answer to Question 1 have on this cash record?

5

If the company have recorded their cash disbursements in the same manner that they recorded their cash receipts, what effect will the new method have upon the cash disbursements journal?

6

When a controlling account is kept with Accounts Receivable, explain the method of recording and posting returned sales.

7

When a controlling account is kept with Accounts Payable, explain the method of recording and posting returned purchases.

8

When controlling accounts are kept with Accounts Receivable and Accounts Payable, explain the method of recording and posting notes received from customers and issued to creditors to apply on account.

9

On the Balance Sheet of the S. H. Smith Company accounts receivable are stated at $9,280.00. Explain how you would test the accuracy of this amount.

10

Explain and illustrate five advantages which may be derived from the use of controlling accounts with Accounts Receivable and Accounts Payable.

LABORATORY MATERIAL

EXERCISE No. 91

D. D. Sells begins business on June 1st, and installs a bookkeeping system consisting of a cash book, purchases journal, sales journal, and general journal, as books of original entry, and of a general ledger, customers' ledger, and a creditors' ledger.

The following are a part of his transactions for the month of June:

June 1. Invests $5,000.00 in cash.
Pays one month's rent in advance, $200.00.
Purchases, for cash, furniture and fixtures, $750.00.
2. Purchases merchandise of Morris Wholesale Co., terms 2/10, n/30, $800.00.
3. Purchases merchandise of James Mercantile Co., terms 1/10, n/60, $1,600.00.
4. Sells Baker & Crosswhite, terms 1/10, n/60, merchandise, $480.00.
Pays freight on merchandise purchased, $47.50.
6. Purchases merchandise of Torr & Co., terms 1/10, n/60, $850.00.
7. Sells L. S. Lyon & Co., terms 2/10, n/30, $840.00.
8. Purchases of A. L. Anderson Co., terms 1/10, n/60, $1,450.00.
9. Sells Madison Mercantile Co., terms 1/10, n/30, $370.00.
10. Pays Morris Wholesale Co., invoice of June 2nd, less discount.
11. Purchases of Morris Wholesale Co., terms 2/10, n/30, $750.00.
Receives from Baker & Crosswhite payment of invoice of June 4th, less discount.
13. Pays James Mercantile Co., invoice of June 3rd, less discount.
15. Purchases of Davidson Mfg. Co., terms n/30, $750.00.
16. Pays Torr & Co., invoice of June 6th, less discount.
Receives from L. S. Lyon & Co. payment of invoice of June 7th, less discount.
17. Returns $30.00 of damaged goods to Davidson Mfg. Co., and receives credit therefore.

June 18. Pays A. L. Anderson & Co., invoice of June 8th, less discount.

Receives from Madison Mercantile Co., payment of invoice of June 9th, less discount.

20. Sells Madison Mercantile Co., terms 1/10, n/30, $800.00.

21. Purchases of James Mercantile Co., terms 1/10, n/60, $1,340.00.

Madison Mercantile Co. return $50.00 of merchandise sold them on June 20th, which they claim is not according to sample.

22. Sells Baker & Crosswhite, terms 1/10, n/60, $480.00.

23. Purchases of Davidson Mfg. Co., terms n/30, $240.00.

24. Sells Marshall Mercantile Co., terms 1/10, n/30, $750.00.

Receives from Baker & Crosswhite payment of invoice of June 22nd, less discount.

25. Pays Davidson Mfg. Co., invoice of June 15th.

Grants claim of Marshall Mercantile Co. for $12.50 because of damaged goods shipped them on June 24th.

27. Purchases of Dodge & Co., terms 1/10, n/60, $800.00.

28. Sells Johnson & Co., terms n/30, $450.00.

Receives from Marshall Mercantile Co. payment of invoice of June 24th, less credit allowed and less discount.

29. Purchases of Weil Mfg. Co., terms n/30, $450.00.

30. Sells Case and Buck, terms n/30, $450.00.

Purchases of Adams & Co., terms 1/10, n/30, $650.00.

Receives from Johnson & Co. payment of invoice of June 28th.

Instructions: 1. Rule a cash book, purchases journal, sales journal, and general journal according to the forms given in Chapter XXIV, and record the foregoing transactions in these books. The investment and other entries in the cash book which do not affect the customers and creditors accounts are entered in the third or "General" column in the cash book.

2. Post and take a Trial Balance from the general ledger accounts.

3. Verify the customers' and creditors' ledgers by comparison with the controlling accounts.

CHAPTER XXV

BOOKS OF ORIGINAL ENTRY

Purpose of Books of Original Entry

Books of original entry are the records in which a preparatory assignment of debits and credits is made for every business transaction. Since it is not desirable to enter transactions directly in the ledger accounts, a preliminary record is made in some book of original entry which serves as a posting medium through which they are passed to the ledger. The journal with its various subdivisions serves as the posting medium in modern accounting practice. Any book or record, however, no matter what its form, in which a transaction is expressed as a debit and credit in such a manner that it can be posted to the ledger, is a book of original entry within the meaning of the foregoing definition. The form of any particular book of original entry will depend upon the nature of the transactions to be recorded therein and the nature of the desired classification of the financial facts arising as a result of these transactions. It is good accounting to vary the form of the record in any way possible to obtain a maximum of information with a minimum of effort.

Subdivisions of the Journal

As previously explained, it is possible to record all the transactions performed by a business in one journal, but it is customary whenever transactions of any particular kind become frequent to record them in a separate journal. Thus the transactions with purchases, sales, cash receipts, and cash disbursements are usually recorded in separate journals. In some businesses there are other transactions which are sufficiently frequent to make it desirable to have them recorded in a separate journal. For instance, if notes are received frequently from customers in payment of their accounts it may be desirable to record them in a notes receivable journal. In the same manner, if notes are issued frequently to creditors in payment of accounts it may be desirable to have a notes payable journal. If customers frequently return goods which they have purchased it is expedient to have a returned sales journal, and if many purchases are returned to creditors it is desirable to have a

returned purchases journal. So in the case of transactions of any kind which are frequent a separate journal is desirable.

In previous chapters the use of simple forms of the general journal, purchases journal, sales journal, and cash journal, and the method of recording simple transactions in them, has been discussed and illustrated. It is the purpose of this chapter to show certain modifications in these forms and to illustrate the recording of more complicated transactions in them. In future chapters the use of the other forms suggested in the preceding paragraph, as well as additional forms, will be discussed and illustrated.

Separate Columns in Books of Original Entry

The primary purpose of separate journals is to provide an analysis and classification of transactions. For instance, transactions are classified as sales transactions, purchases transactions, cash receipt transactions, cash disbursement transactions, and miscellaneous transactions, and are recorded accordingly. Sometimes, however, it is desirable to have a further analysis. The cash receipts journal provides a record of all cash received, but cash is received from different sources and it may be desirable to have a classification of cash which will indicate the source from which it comes. As explained in the preceding chapter, cash is frequently received from customers in payment of their accounts. In a retail business considerable cash is usually received as a result of cash sales. In addition, some cash may be received from miscellaneous sources, such as interest on notes of customers, sales of fixed assets, services performed for others, etc. Consequently, it is frequently desirable to have cash receipts classified so as to show the amount received from customers in payment of accounts, the amount received from sales, and the amount received from miscellaneous sources.

It would, of course, be possible to have three journals with cash receipts and to record the cash received from each source in a separate journal. These transactions, however, are all alike from one viewpoint—they all are cash receipts, and it is desirable to have them recorded in the same journal so the total cash receipts can be easily obtained at any time and an audit of cash receipts can be made readily. This can be accomplished and still provide an analysis by sources by introducing separate columns in the cash receipts journal and recording the cash received from each source in a separate column. The total of each column will show at any time the total cash received from the source indicated by the caption of

the column. In addition, there will be a column which will show the total of the cash received from all sources. Such a form of record of cash receipts is given in Chapter XXIV.

The foregoing discussion of the cash receipts journal illustrates the use and function of special columns in books of original entry. In the same manner that transactions which are very frequent may be taken out of the general journal and recorded in a separate journal, transactions of any particular kind which are recorded in one of the separate journals may become sufficiently frequent and important, to be taken out of the general column of the separate journal and recorded in a separate column. From henceforth the student will have occasion to use various columns in books of original entry as transactions involving more complicated business statistics are introduced. The use of special columns with reference to the cash journals is discussed and illustrated in this chapter. The use of special columns in the purchases and sales records will be discussed in Chapter XXXI.

The Recording of Purchases

There are many different ways of handling and recording purchases, every concern having its more or less individual methods. The purchase routine, like the entire accounting system, should be adapted to the internal organization of the particular business concerned. The present discussion, however, is concerned only with the method of making the record of purchases. A discussion of the routine involved in the making of the purchase and the receipt of the goods into stock is postponed until a subsequent chapter.

Each purchase made should be represented by an invoice. When the invoice is received it should be verified as to quantity, terms, price, and extensions after which it is ready for entry. There are various forms of purchase records employed. At one time the so-called *invoice book* was in prevalent use. By this method the invoices were pasted in a book, three or four being placed on a page, and the amount extended in a column at the edge of the page. This eliminated the necessity of copying the invoice and thus decreased the work of recording purchases. In a business, however, where many purchases are made, the invoice book soon becomes quite bulky and inconvenient. The invoices received are of various sizes, which also causes some difficulty in adapting them to the size of the book. Consequently, the invoice book is little used at the present time. In some cases the invoices are filed in a loose leaf

binder and the postings to the creditors' accounts made from the invoice, while the postings to Purchases and Accounts Payable at the end of the month are made by totalling all the invoices in the binder which have been received during the month. In other cases, the purchases of merchandise are recorded with purchases of expenses, supplies, and other commodities in a record known as the *voucher register*, which will be explained in a subsequent chapter.

A purchase record which is simple and yet in many businesses is sufficiently comprehensive may be illustrated by the following form:

June 192

Date	L.F.	Account Credited	Address	Date of Invoice and Terms	Inv. No.	Amount
1		A. D. Langley	City	May 28 1/10 n/30	1	371 60
3		O. P. Pines	Denver	June 1. 1/10 n/30	2	467 86
4		J. C. Tolan	St. Paul	June 1-acct	3	611 84
6		A. A. Mann & Co.	Chicago	June 2-60 days	4	701 10
10		Selwyn & Co	St. Louis	June 8-2/10 n/30	5	110 63
16		Fehr & Thomas	Kansas City	June 14-acct	6	311 17
21		A. B. ZuTavern	Los Angeles	June 16-1/20 n/60	7	321 40
30		Purchases Dr.				2895 60

Illustration No. 31—Purchases Journal

The use of the columns in this record is apparent from the headings given.

The Recording of Cash Purchases

There is some difference of opinion as to the proper method of handling cash purchases. In some cases they are entered in the cash book alone, from which Purchases is debited and Cash credited. In other cases they are entered in the purchases record the same as purchases on account, the Purchases account being debited and Accounts Payable account credited. The cash paid is entered in the cash book, the Accounts Payable account being debited and Cash credited. In most cases the latter method is preferable, since it requires all invoices received to be recorded in the purchase record and therefore leads to a uniform routine. In most businesses cash purchases are not numerous, so the extra labor involved in making the two entries is rather immaterial.

Posting the Purchases Journal

The credits to the accounts of the individual creditors should be made at the time of the entry in the purchases journal. This is necessary in order that each creditor's account will show the amount due to him at any time. The entry to the creditor's account is often made from the invoice instead of being posted from the purchases journal. At the end of the month, or whenever the Trial Balance is made, the total of the "Amount" column is posted to the debit of Purchases and to the credit of Accounts Payable.

The Recording of Sales

Like the recording of purchases, the method of handling and recording sales varies somewhat, depending on the organization and internal routine of each particular business. The present discussion, however, is concerned only with the method of making the record of sales. A discussion of the routine involved in the making of the sale and the delivery of the goods is postponed to a subsequent chapter.

Each sale is usually represented by an invoice or sales ticket and a copy of this invoice or ticket is retained by the business making the sale. This copy serves as the basis of the entry for the sale on the accounting records. There are various forms of sales records employed. In some cases the copy of the invoice is filed in a loose leaf binder and this serves as a record. In this case the postings to the Customer's account in the Customers' ledger is made from the invoice at the time of the sale. At the end of the month the total of all the invoices issued during the month is obtained and debited

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Date	L.F	Account Debited	Address	Terms	Sale No	Amount	
2		A. M. Anderson	Dayton	30 days	1	520	
4		Jones & Smith	1601 Carll St. City	2/10 n/30	2	137	03
		H. B. King	Greenville	1/10 n/30	3	462	40
10		J. O. Murdock	318 Walnut St. City	2/10 n/30	4	611	37
21		O. L. James	107 Elm St. City	1/10 n/30	5	431	60
29		A. M. Anderson	Dayton	30 days	6	101	34
		Sales Cr.				2263	74

Illustration No. 32—Sales Journal

Cash Receipts

Date	L.F.	Account Credited	Explanation	Accts Rec. Cr.	Sales Disc't Dr.	General
June 1		H. B. Adams Prop.	Investment			3000
3		A. M. Anderson	On account	146 80		146 80
6		J. O. Murdock	In full of a/c	240	4 80	235 20
7		H. B. King	On account	462 40	4 62	457 78
10		Notes Receivable	J. T. Sletten			360 80
		Interest Received	On above note			4 75
30		O. L. James	On account	245 80	2 46	242 34
		Accounts Receivable Cr.		4178 31		
		Sales Discount Dr.			81 35	
		Cash Dr.				10418 79
						10418 79
July 1		Balance				1787 07

Illustration No. 33—Debit Side of the Cash Book

to Accounts Receivable and credited to Sales. In some cases the invoices are bound in book form, three or four to the page, with blank pages intervening. By the use of a carbon, a copy of the invoice is made on the intervening page and this serves as a sales record. The page on which the invoice appears is perforated so that the individual invoice can be easily removed. This method is convenient if it is not desirable to use the typewriter in making the invoice. Since, however, the typewriter is ordinarily used in billing work, this form of sales record is usually not practicable.

A sales record which is quite simple, yet in many businesses is sufficiently comprehensive, may be as in Illustration No. 32, page 339. The use of the columns in this record is apparent from the headings given.

The Recording of Cash Sales

In a wholesale business cash sales are not frequent and it is customary to record them in the sales record, debiting the account of the customer and crediting Sales. The cash received is entered in the cash book which debits Cash and credits the customer, thereby canceling the debit made through the sales journal. In a retail business where cash sales are numerous it would serve no useful purpose and be very burdensome indeed to make a separate entry

Cash Payments

Date	LF	Account Debited	Explanation	Accts Pay Dr	Pur Disc't Cr	General
June 1		Furniture & Fixtures	Check No 1			1340
2		Administrative Expenses	" " 2			27 50
3		A. D. Langley	" " 3	371 60	3 72	367 88
4		Selling Expenses	" " 4			26 74
7		O. P. Pines	" " 5	467 86	4 68	463 18
9		Administrative Expenses	" " 6			150
10		W. R. Carter	" " 7	200		200
30		A. B. Zu Tavern	" 45	321 40	3 21	318 19
		Accounts Payable Dr.		5001 63		
		Purchases Discount Cr.			101 13	
		Cash Cr.				8631 72
		Balance				1787 07
						10418 79

Illustration No. 34—Credit Side of the Cash Book

for each cash sale. Consequently, it is customary to total the cash sales for the day and make an entry in the cash record, debiting Cash and crediting Sales.

Posting the Sales Journal

The debits to the accounts of the individual customers should be made at the time of the entry in the sales journal. This is necessary in order that each customer's account will show the amount due from him at any time. The entry to the Customer's account is often made from the invoice instead of being posted from the sales journal. At the end of the month, or whenever the Trial Balance is made, the total of the "Amount" column is posted to the debit of Accounts Receivable and to the credit of Sales.

The Recording of Cash

As explained in Chapter XII, the recording of cash involves the use of two journals, one for cash receipts, and one for cash payments, and these journals together constitute the cash record which is frequently termed the *cash book*. The form of the cash book will depend on the extent to which it is deemed desirable to analyze cash receipts and cash disbursements. In most businesses it is at

least necessary to show the analysis indicated in Illustrations Nos. 33 and 34. In many businesses a more extensive analysis is desirable. Other forms of cash books will be illustrated in subsequent chapters.

The use of the columns in Illustrations Nos. 33 and 34 should be apparent from the headings and the entries given in the illustration.

Posting the Cash Book

On the debit side of the cash book the items entered in the ''Accounts Receivable'' column are posted to the credit of customers' account in the customers' ledger. The items in the ''General'' column which do not appear in the ''Accounts Receivable'' column are posted to the credit of the account indicated in the ''Account Credited'' column. The total of the ''Accounts Receivable'' column is posted to the credit of Accounts Receivable; the total of the ''Sales Discount'' column is posted to the debit of Sales Discount, and the total of the ''General'' column is posted to the debit of Cash. The posting of these totals is indicated in the illustration.

On the credit side of the cash book the items entered in the ''Accounts Payable'' column are posted to the debit of the Creditors' account in the creditors' ledger. The items in the ''General'' column which do not appear in the ''Accounts Payable'' column are posted to the debit of the accounts indicated in the ''Account Debited'' column. The total of the ''Accounts Payable'' column is posted to the debit of Accounts Payable; the total of the ''Purchases Discount'' column is posted to the credit of Purchases Discount, and the total of the ''General'' is posted to the credit of Cash. The posting of these totals is indicated in the illustration.

QUESTIONS FOR CLASS DISCUSSION

1

S. P. Meech, retail storekeeper, receives cash from the following sources: cash sales, accounts receivable, and miscellaneous. He desires to have his cash receipts classified so he may know the amount of cash received from each source. Explain the nature of the record which you would advise in order to make this possible.

2

Mr. Meech requests you to install a new system of records for his business. Explain your method of procedure and state what information you would desire before you attempted to design his records.

3

Mr. Meech states that sometimes customers do not understand the debits which have been made to their accounts and that he finds it necessary to trace these charges back to the book of original entry and even to the invoice or sales ticket. He desires to know how this reference may be made readily. Explain to him the proper procedure.

4

Explain how the terms of sale may be shown on the sales ticket, the sales record, and in the accounts.

5

Explain the method by which purchases may be recorded without copying in a purchase record the information shown on the invoice. Is this a desirable method for the recording of purchases? Why?

6

The St. Louis Retail Store purchases from The Chicago Wholesale Company $500.00 merchandise for cash. Explain two ways in which this transaction may be recorded on the books of The St. Louis Retail Store and explain the most desirable method. State your reasons.

7

Most retail stores do not post their purchase and their sales records until the end of the month. In such cases how is it possible to determine the amount due from any particular customer during the month?

Explain two methods by which a record of sales may be made without copying the invoice or sales ticket in a sales record. Explain the advantages and disadvantages of each method.

9

R. M. King Company, wholesale dealers in hardware, sell $580.00 worth of hardware to the Lee Hardware Company for cash. Explain the method of recording this sale.

10

The James Mercantile Company, retail merchants, sell $25.80 worth of merchandise to R. E. Taylor for cash. Explain how this sale would be recorded. Explain why this sale would be recorded differently from the one given in the preceding question.

11

J. B. King purchases $500.00 of merchandise, terms 2/10, n/30. He makes remittance within the discount period. Explain how this transaction will be recorded in the books of original entry and the effect which it will have on the ledger accounts.

12

Furniture and fixtures to the amount of $456.00 are purchased for cash. Explain how this transaction will be recorded. If the furniture and fixtures mentioned in the preceding question were purchased on account, how would the transaction be recorded?

13

Merchandise to the amount of $356.00 is purchased from R. M. Barnes, terms 1/10, n/60. Assuming that payment is made within the discount period, explain the method of recording and posting this transaction.

14

Explain fully the method of posting the debit side of the cash book where there are separate columns for accounts receivable, sales discount, and general items.

15

Explain fully the method of posting the credit side of the cash book where separate columns are maintained for accounts payable, purchases discount, and general items.

LABORATORY MATERIAL

Practice Set No. 3

Purpose of Set

The purpose of the laboratory material given in Chapters XXV-XXXVI, inclusive, is:

1. To give the student a comprehensive idea of an accounting system as a whole. To that end practice is afforded in the use of the more important journals, the posting of these journals, the taking of Trial Balances, the preparation of financial reports, and the summarization of the operations at the end of a fiscal period.
2. To illustrate by means of the laboratory material the application of the principles discussed in the text.

In order that the *principles* involved may be emphasized, details are reduced to a minimum. Clerical work is eliminated as much as possible in order both to save time and to avoid confusion. This is in conformity with the method followed throughout this text, of emphasizing *principles* rather than *practices*. The former are of general application, while the latter vary widely.

The material in the various chapters is so arranged that each new principle is explained in the text discussions before it is introduced in the laboratory material. This is also in conformity with the method followed throughout the text, of having the accounting principles discussed, explained, and illustrated before their application is required in the laboratory exercises.

Description of Practice Set

This set represents a wholesale hardware business conducted by a partnership. The partnership form of organization is employed because the student has not yet studied the corporate form. With the exception of the transactions affecting the proprietorship accounts, the transactions and the records would be the same if the business were conducted by a sole proprietor or a corporation.

The transactions given in this exercise are taken in the main from the records of a large hardware business. The purchases and the sales represent transactions performed by this business, although in some cases the number of the items and consequently the amount of the invoice have been reduced. The number of

transactions performed is, of course, much smaller than would be performed by the business in question in the length of time represented by the set. It will also be realized that the records employed are more simple and that the accounts used are fewer in number than would be employed by a large business. This, however, does not affect the principles involved and is necessary for the sake of brevity and simplicity.

Although this practice set is adapted from the records of a hardware business, it is not its primary purpose to illustrate the accounting for such a business; rather, this business was chosen because the transactions performed by it were deemed very representative of the transactions performed by business firms in general. These transactions are also suitable to illustrate the application of the principles which are deemed of primary importance to the beginning student, and can be applied to any line of business.

The transactions cover a period of three months. At the end of the first month the student takes a Trial Balance, but does not prepare financial reports or close the ledger. This is to emphasize the fact that a Trial Balance is taken frequently when the reports are not made or the ledger closed. At the end of the second month a Trial Balance is taken, a Balance Sheet and Statement of Profit and Loss prepared, and the ledger closed. The method of continuing a set of books after closing is illustrated in the recording of the transactions for the third month. At the end of the third month, a Trial Balance is taken, the accounting reports, including a comparative Balance Sheet and Statement of Profit and Loss, are prepared, and the ledger is closed. During the third month the use of departmental accounts with merchandise is illustrated.

The Accounts Used

Before making any entries, the student should familiarize himself with the accounts given on the following page. The number immediately preceding each account title indicates the page on which the account is to be opened in the ledger. If two or more accounts appear on the same page, the page should be divided equally between them, unless the required space is indicated.

Outline of Accounts Used in January and February

For the sake of simplicity only a few expense accounts are used during the first two months of the set. This necessitates that each account be charged with a number of miscellaneous items. For instance, the Administrative Expenses account will be charged with

the rent of the store, the office salaries, the cost of light, water, etc. During the last month's work some of these accounts will be subdivided. Instructions will be given at the proper time with reference to the subdivisions which should be made. If the accounts are opened as indicated in the following outline, there will be sufficient space in the ledger for these additional accounts.

1. Cash
1. Notes Receivable
2. Accounts Receivable (2/3 page)
2. Reserve for Bad Debts (1/3 page)
3. E. D. Carpenter
3. Merchandise Inventory
3. Prepaid Insurance
4. Office Supplies
4. Shipping Supplies
4. Furniture and Fixtures
4. Reserve for Depreciation of Furniture and Fixtures
5. Stockroom Equipment
5. Reserve for Depreciation of Stockroom Equipment
5. Delivery Equipment
5. Reserve for Depreciation of Delivery Equipment
6. Notes Payable (1/3 page)
6. Accounts Payable (2/3 page)
7. Expenses Accrued
7. Wages Accrued
7. Thompson Bros.
7. Muskegon Motors Company
8. Frank H. Long, Capital
8. Frank H. Long, Personal
9. Paul K. Humphrey, Capital
9. Paul K. Humphrey, Personal
10. Sales
11. Sales Returns
11. Sales Allowances
12. Freight, Express and Cartage Outward
13. Purchases
14. Purchases Returns
14. Purchases Allowances
15. Freight, Express and Cartage Inward
16. Buying Expenses
17. Selling Expenses

19. Delivery Expenses
20. Administrative Expenses
22. Receiving and Shipping Expenses
22. Purchases Discount
23. Interest Received
23. Sales Discount (½ page)
23. Interest Paid
24. Profit and Loss

Customers' and Creditors' Accounts

The individual accounts of the customers and creditors will be kept in separate ledgers. The accounts are to be opened as they are required at the time of posting. Allow ten lines for each account.

Books of Original Entry

The cash book, the sales journal, and the purchases journal used during the first two months will be ruled to correspond with the illustrations of these records given in Chapter XXV. The sales and purchases records used for the last month will be ruled to correspond with the illustrations given in Chapter XXXII. The sales returns and allowances and the purchases returns and allowances will be recorded in the general journal.

Business Papers

This set is arranged so that it may be used with or without business papers at the option of the instructor. The material in the text is arranged for use without the business papers. If it is desired to use the business vouchers, supplementary material will be provided for this purpose.

Instructions and Explanations

It is assumed that, if the student has mastered the subject-matter of the text, he will be able to record these transactions without detailed instructions. Consequently, few instructions are given in connection with the laboratory material. When in doubt as to how a transaction should be recorded, the student should consult the instructor.

Preliminary Data

Frank H. Long has been head of the Tools Department of the Morton Wholesale Hardware Company. Paul K. Humphrey has been sales manager for a competing concern. They agree to form a

partnership and organize a wholesale hardware business. Each is to invest $8,500.00 in cash.

The articles of copartnership which are to govern their relations in the business and to which they both subscribe contain the following conditions:

Each partner shall invest $8,500.00 in cash; devote his entire time to the business and share equally the profits or losses resulting from the operations. Frank H. Long is to have charge of the office, buying, credits, etc., and to receive a salary of $175.00 per month; Paul K. Humphrey is to devote his time to selling, either on the road or in the store, and to receive a salary of $150.00 per month.

A copy of the articles of copartnership is provided when the business papers are used in connection with the transactions.

Transactions for January

January 2

Each partner has invested $8,500.00 according to the articles of copartnership.

Enter the investment of each partner in the cash book. Make a memorandum of the important points in the articles of copartnership in the journal.

Deposited the $17,000.00 in the Merchants' National Bank.

No entry is required for the deposit unless the transactions are represented by reproduced business papers, in which case full explanation is given relative to the required entry for cash deposited in the bank.

Paid the People's Title & Trust Co. $150.00 rent for January.

Enter in the cash book; debit Administrative Expenses. All cash payments are made by check except those made from the petty cash fund, which will be explained in the next chapter. The student is not required to write checks unless the reproduced business papers are used to represent the transactions, in which case full information will be given.

Purchased for cash from the Office Supply Co., office furniture, $135.00; typewriter, $100.00.

January 3

Paid J. H. Hall, an expert accountant, $145.00, $120.00 for his services in installing an accounting system, and $25.00 for the books and records supplied by him. Debit Administrative Expenses.

Bought from J. F. Reinhart Manufacturing Co., Liberty Mills, merchandise per purchases invoice No. 1, terms 2/10, n/60, $638.70.

When the name of the state is not indicated, the student will use his home state. In practice, the date of an invoice may be prior to the date of entry, depending upon the distance. In this set, unless otherwise instructed, the student will use the same date for the day of entry and the invoice date. Post from the purchases journal as the transactions are recorded in it.

Gave the International Lloyds Co. a check for $150.00 in payment of premium for one year's insurance on merchandise.

January 5

Engaged a stenographer at a salary of $25.00 per week and a shipping clerk at a salary of $30.00 per week.

No entries are required but the student should make a memorandum for future reference. Head a sheet of paper "Pay Roll" and record thereon the names of all employes and their salaries.

Purchased from Thompson Brothers equipment for the stockroom, $600.00, terms net cash in 15 days.

Enter in the journal.

Bought from Henry Disston & Co., Philadelphia, merchandise per purchases invoice No. 2, terms 2/10, n/60, $776.40.

January 6

Sold Fred. Dole, Clinton, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 1, $141.40.

If the business papers are used to represent the transactions, a sales invoice showing the items sold is prepared from the order received. Post from the sales journal as the transactions are recorded in it.

Prove cash; balance $16,320.00.

(Continued on Page 363)

CHAPTER XXVI

BUSINESS PRACTICE AND PROCEDURE

Need for Consideration

In Chapter XXV certain books of original entry which are used as a means of making a preliminary record of business transactions have been discussed. In Chapters XV and XVI some of the more important of the business forms which serve as an evidence of the transactions which are recorded in the books of original entry have been explained and illustrated. It is now necessary to notice the business practice and procedure involved in the performing of the more important types of business transactions and the place and function of business forms or vouchers in the routine of this procedure. It is also necessary to explain the use of certain additional business forms.

Methods of Handling Purchases

There are many different ways of handling purchases, every concern having its more or less individual methods. The purchase routine like the entire accounting system should be adapted to the internal organization of the particular business concerned. In a small business the buying may be done by the owner himself or by an assistant. In a larger business there is usually a purchasing department under the control of a purchasing manager or purchasing agent.

If there is a purchasing department the purchasing agent will make purchases in response to a written request from some department of the business. For instance, the general office may request the purchasing department to purchase some stationery for office use, or the stores department may request the purchase of certain steel bolts which are used in manufacturing the commodity produced by the business. Such a request is termed a *requisition*. It may be made in various forms, but should at least contain the information indicated in the illustration at the top of page 352.

PURCHASE REQUISITION No. *121*

Date *May 1, 192* From *L. M. W.*

Quantity *1*

Article *Dalton Adding Machine*

Date Required *May 15, 192*

Advise Mr. *Walker* on delivery

Required for *D pt. A.*

Purchase Order No. *485* Date *May 2*

Issued to *Dalton Adding Machine Co.*

Originated by *M. H.* Approved by *W. H. S.*

Illustration No. 35—Requisition

Whatever the organization of a particular business may be, the buying process is initiated by the placing of an order for the thing to be purchased. When there is a separate purchasing department this order will usually be made on a specially prepared *order* blank. In other cases the order may consist of only a letter written by the proprietor or his assistant, or it may be merely a verbal order given to a representative of the firm from whom the purchase is made. But even in the last case the oral order should be confirmed by a written statement and a copy of this statement retained in the files. In other words, it is desirable that the business has in some form a copy of each order given. Such orders may be made in various forms, but should at least contain the following information: date, name and address of the person or firm from whom the merchandise is ordered, date and method of shipment, shipping address, terms, items ordered, and signature of person making the order.

Usually an invoice is received by the customer from the creditor before the goods are received. In form, the invoice may be as shown in Illustration No. 13. The invoice should be sent direct to the purchasing department, or to the party responsible for the purchase, where it should be compared with the copy of the purchase order as to price, terms, and quantity. When the goods arrive they should be inspected and counted. The quantities may be checked against the invoice; or, preferably, a separate report may be made to the purchasing agent giving the quantities received, in which case this report will be compared with the invoice by the purchasing department. Although it is desirable that the invoice

be compared with the report of the goods received before it is entered, this is often impracticable. If it is desired that the discount offered be taken, it is often necessary to enter both the purchase and the payment therefor before the goods arrive. In this case the invoice should later be compared with the report of the receiving department, which gives the amount received, and if a shortage exists a claim can be filed with the creditor for a refund.

After the invoice has been verified as to quantity, terms, and price by the purchasing department, the owner, or the party who made the purchase, it will be sent to the accounting department. Here the extensions will be verified and it is then ready for record. The method of making the record has been explained in Chapter XXV.

Method of Handling Sales

The method of handling sales, like the method of handling purchases, varies greatly, depending on the organization and nature of the particular business. In every case, however, the sale is made in response to an order received from the customer. This order may be given orally, which is the usual method in a retail store, or it may be received in written form, which is the usual method in a wholesale or manufacturing business.

When the order is received from the customer an invoice or sales ticket is prepared. In a retail store the customer usually gives a verbal order to the clerk and the latter prepares the sales ticket in duplicate, giving the original copy to the customer and sending the carbon copy to the accounting department, from which the entry in the sales record is made. In a wholesale or manufacturing business the written order is received direct from the customer or from the salesman who has obtained it from the customer. Usually the order, after it has been approved by the credit department, is sent to the billing department where the invoice is prepared.

At least two copies of the invoice are made by the billing department. The original is sent to the customer and the copy is sent to the accounting department where it serves as a basis for the entry in the sales record. Sometimes additional copies of the invoice are made for the use of different departments of the business. For instance, the credit department may desire a copy which will aid it in following up the payment thereof, or the treasurer may desire a copy so he may the better estimate the funds to be obtained from sales. Sometimes a copy of the invoice is sent to the store room or warehouse and this serves as instructions for the shipping of the goods.

Shipping or Delivery of Merchandise

After a sale is made it is necessary to deliver the goods sold to the customer. In a retail store the goods may be delivered over the counter at the time of the sale, or they may be delivered to the customer's home by means of the delivery service maintained by the business. In either case the procedure is simple and no particular business forms are involved in the process.

In a wholesale business, merchandise may be delivered by parcel post, by express, and by freight. When merchandise is shipped by express the shipper receives an *express receipt*, and when it is shipped by freight the shipper receives a *bill of lading*. The bill of lading has been discussed and illustrated in Chapter XV.

In some cases the credit standing of the purchaser may be doubtful and the shipper may be unwilling to ship the merchandise on open account. In this case the shipper may draw a draft on the purchaser, attach this draft to the bill of lading, and deposit both the bill of lading and the draft with his local bank. The bank will forward the bill of lading with draft attached to a bank in the city of the purchaser. In the meantime, the shipper will notify the purchaser where the draft and bill of lading can be obtained. The purchaser will call at the bank to which the bill of lading has been sent and by paying the draft will obtain the bill of lading. He can then obtain his merchandise from the transportation company. This method of shipping goods is known as *bill of lading with draft attached.*

Method of Handling Cash Receipts

Cash may be received from various sources and in various forms. A business may receive cash in the form of checks, currency, post-office and express money orders, postage or credits from the bank for notes discounted, or notes or drafts collected. From whatever source received or in whatever form, it is necessary that the cash received be shown in two ways: first, as a cash receipt in the cash book, and secondly, as a deposit in the bank. All cash received should be deposited in the bank and on the day received if that is possible.

In a retail business cash receipts are almost entirely from cash sales and from payments on account by customers. The receipts from cash sales are verified by comparing them with the duplicate sales tickets after which they can be entered in the cash record and turned over for deposit. It is desirable that the cash received from

customers to apply on account should not be received and deposited by the same person who makes the entries to the customers' accounts.

In a wholesale business the cash receipts are received in the main through the mail from customers who are making payments on account. If desired, such cash may be received by a clerk, who makes a record of the amount before it is passed to the cashier, in which case his record will serve as a check on the deposits made by the cashier or treasurer.

Monthly statements should be obtained from the bank and the deposits shown by these statements can be checked against the cash receipts as shown by the cash record. Since all cash receipts should be deposited, the cash receipts and the deposits should be the same. Amounts placed to the credit of the firm for discounted notes or collections can also be verified from the monthly bank statements.

Method of Handling Cash Payments

Only disbursements by check should be recorded in the cash book. Checks should be issued for all payments except such as are of very small amount, and these should be provided for by the establishment of a petty cash fund. Currency payments should not be made directly from the general cash.

A petty cash fund is an amount withdrawn from the general cash and kept entirely separate from it. It is established by drawing a check to the order of Petty Cash for the estimated amount of the currency disbursements for a certain period of time, frequently for one month. The check is recorded in the cash book in the usual way, debiting Petty Cash and crediting Cash. The check is then converted into currency and the currency is placed in a special drawer called the "petty cash drawer." All currency disbursements should be made from this drawer and recorded in the petty cash book. The form of the petty cash book may be as follows:

Petty Cash Book

Date	Explanation	Receipts	Disbursements		
			Admr. Exp.	Sell. Exp.	Misc.

At the end of the month a check is drawn for the amount of the petty cash disbursements for the month, and this is entered in the cash book, debiting the proper accounts as indicated by the petty cash book and crediting Cash. This check is then converted into

currency, the currency put in the petty cash drawer, and the proper entry made in the petty cash book. This makes the cash in the petty cash drawer equal to the amount there at the beginning of the month.

To illustrate the use of the petty cash fund as described above: Assume that a petty cash fund of $50.00 is established at the beginning of the month. Now assume that $21.00 was spent during the month and charged to Selling Expenses and $22.60 spent and charged to Administrative Expenses as shown by the "Selling Expenses" and "Administrative Expenses" columns of the petty cash book. At the end of the month the petty cash bookkeeper will present a statement showing that $43.60 has been spent and a check will be drawn for this amount. The check will be recorded in the cash book, debiting Selling Expenses for $21.00 and Administrative Expenses for $22.60 and crediting Cash for $43.60. When this check is cashed and the currency placed in the petty cash drawer the petty cash on hand will be the original amount, $50.00.

Method of Handling Notes Receivable and Payable

If the notes received by a business from its customers are not too numerous they may be recorded in the general journal and posted individually to the debit of Notes Receivable. If such notes are received quite frequently, it is usually expedient to have a separate Notes Receivable column in the journal, the total of which

NOTES RECEIVABLE

Date Received	Our No	(Draft) (Note) DRAWER OR ENDORSER	(Note) (Draft) MAKER OR DRAWEE (Payer)	IN WHOSE FAVOR (Payee)	WHERE PAYABLE
April 16	1	Young & Doyle	James B Ford	Young & Doyle	Merchants Natl Bank
24	2	Lee & Roberts	Moses A Palmer	Lee & Roberts	Cleveland Natl Bank
30	3		A K Harper & Co	C W Keeland & Co	Bank of Maryville
May 11	4		Young & Doyle	C W Keeland & Co	Merchants Natl Bank
11	5	C W Keeland & Co	W H Ingram	First Natl Bank Pittsburgh	First Natl Bank

Illustration No. 36—Left Page of Notes Receivable Book

NOTES RAYABLE

Date Received	Our No	(Draft) (Note) DRAWER OR ENDORSER	(Note) (Draft) MAKER OR DRAWEE (Payer)	IN WHOSE FAVOR (Payee)	WHERE PAYABLE
April 6	1		C W Keeland & Co	Hall Safe & Lock Co	Merchants Natl Bank
6	2		" "	" " " "	" " "
10	3	Capital Grain Co	" " "	Third Natl Bank Denver	" " "
19	4	L. Fowler	" " "	Merchants Natl Bank	" " "
21	5	J Allen Smith & Co	" " "	" " "	" " "
21	6	Western Hay & Grain Co	" " "	" " "	" " "

Illustration No. 37—Left Page of Notes Payable Book

is posted to the debit of Notes Receivable. If the number of notes received is very large it may be expedient to have a separate Notes Receivable journal in which to record them.

In the present discussion it will be assumed that all notes received by the business are recorded in the journal. In a subsequent chapter the use of the notes receivable journal as a book of original entry will be explained and illustrated. Although the journal may serve satisfactorily as a posting medium for transactions involving the receipt of notes receivable, there is considerable detailed information of importance with reference to the note which can not be shown in the journal entry. For instance, the rate of interest, the endorsers, if any, and the time of payment can not be shown very conveniently in the journal entry. Even if these details were given in the journal entry it would be inconvenient to refer to them. It is also inconvenient to refer to the note itself when this information is desired. It has become customary, therefore, after the note has been entered in the journal to make a supplementary record of it in another record known as the *notes receivable book*. The form of such a book is shown in Illustration No. 36. The use of the various columns shown in the illustration is indicated by their headings.

The foregoing discussion of the method of handling notes receivable applies equally well to the method of handling notes payable. The form of the supplementary record with notes payable, usually termed the *notes payable book*, is shown in Illustration No. 37.

NOTES RECEIVABLE

Date of Paper: Year	Month		Time to Run	When Due: Year	1	2	3	4	5	6	7	8	9	10	11	12	Amount		Rate of Int.	When Paid			Remarks
191	Mch	1	60 da	191				30									250		6%	May	1	191	Left at bank 4/25
191	Apr	14	30	191					14								97	65			14	191	
191		29	20 "	191					19								300				22	191	Sent to bank 5/7
191	May	11	30	191						10							364	70	6%	June	11	191	Left at bank 5/8
191		11	Sight	191													194	37		May	16	191	

Illustration No. 36—Right Page of Notes Receivable Book

NOTES PAYABLE

Date of Paper: Year	Month		Time to Run	When Due: Year	1	2	3	4	5	6	7	8	9	10	11	12	Amount		Rate of Int.	When Paid			Remarks
191	Apr	6	30 da	191					6								70			May	7	191	
191		6	60 "	191						5							50			June	5	191	
191		7	10 "	191				17									256	80		Apr	15	191	
191		21	30 "	191					21								300			May	21	191	
191		25	30 "	191					25								121	20			25	191	
191		25	3 "	191					1								669	13		May	1	191	

Illustration No. 37—Right Page of Notes Payable Book

The Trade Acceptance

During the past few years there has been much discussion of the use of a special form of the draft known as the *trade acceptance.* The Federal Reserve Board defines a trade acceptance as "a bill of exchange drawn by the seller on the purchaser of goods sold, and accepted by such purchaser."

Illustration No. 38 shows the form of a trade acceptance which has been approved by the American Trade Acceptance Council. A comparison of the trade acceptance given in Illustration No. 38, with the accepted draft given in Illustration No. 20, will show that they are practically the same. The principal difference is that the trade acceptance shows on its face that it has arisen out of a purchase of goods by the acceptor. On the other hand, the ordinary acceptance may arise as the result of any transaction by which the acceptor becomes indebted to the drawer.

TRADE ACCEPTANCE

No. 130 Feb. 19 19

To Union Grocery Co. Los Angeles Calif.

On Mar. 21, 192 Pay to the order of Ourselves
(DATE OF MATURITY)

Two Hundred Sixty-one 13/100 Dollars, ($261 13/100)

The obligation of the acceptor hereof arises out of the purchase of goods from the drawer. The drawee may accept this bill payable at any bank, banker or trust company in the United States which he may designate.

Accepted at Los Angeles on Feb. 24 192

Payable at Second National Bank

Union Grocery Co.
(SIGNATURE OF ACCEPTOR)

By A. R. Smith

By Frazer & Palmer

By L. M. Palmer

Illustration No. 38—Trade Acceptance

The use of the trade acceptance may be explained by an illustration. Frazer & Palmer, of Chicago, sell $261.13 worth of merchandise to Union Grocery Co., of Los Angeles, terms net 30 days with an agreement that The Union Grocery Co. will accept a thirty-day draft. Frazer & Palmer draw such a draft, using the form prescribed for a trade acceptance as given in Illustration No. 38. The Union Grocery Co. accepts the draft and returns it to Frazer & Palmer. The latter may keep it for thirty days and then present it for payment or, if they desire, they may discount it at their local bank.

In the latter case the bank will give Frazer & Palmer credit for the proceeds of the draft at the time it is discounted and at the

maturity of the draft will send it to some Los Angeles bank, which will collect it from The Union Grocery Co.

Accounting for Trade Acceptance

The accounting for trade acceptances may be explained by taking the illustration given above. When Frazer & Palmer ship the merchandise to The Union Grocery Co., they will debit Accounts Receivable and credit Sales. When they receive the trade acceptance from The Union Grocery Co. they will debit Notes Receivable and credit Accounts Receivable. If they keep the draft until maturity and collect it from The Union Grocery Co., they will debit Cash and credit Notes Receivable. If they discount the acceptance at the bank it will be necessary to debit Cash for the proceeds of the draft, debit Interest for the discount charged by the bank, and credit Notes Receivable for the face of the acceptance. In other words, a trade acceptance drawn on a customer and accepted by the customer is treated as if a note receivable. In the same manner a trade acceptance drawn on the business and accepted by it is treated as a note payable.

If numerous trade acceptances are received by a business it may be desirable not to record them in the Notes Receivable account, but to record them in a Trade Acceptance account. The value of this method is to make possible the showing of trade acceptances and notes receivable as separate items on the Balance Sheet. A business would normally be given a higher credit rating if its Balance Sheet showed a large item of trade acceptances than if it showed a large item of notes receivable. The reason for this distinction is that trade acceptances are usually received at the time the merchandise is sold, while notes receivable are often received in payment of overdue accounts.

In the same manner trade acceptances accepted by the business should be recorded in a separate account if they are numerous.

QUESTIONS FOR CLASS DISCUSSION

The Brown Manufacturing Company maintain a purchasing department under the management of a purchasing agent. The general office of the company desires some stationery for office use. Explain the method by which it would obtain the purchase of this stationery.

2

Explain the purpose of the purchase requisition.

3

Explain the difference between the purchase requisition and the purchase order.

4

The purchasing agent of the James Cannon Company finds it necessary frequently to order certain goods by telegraph. In such cases, what procedure should be followed after the order has been made?

5

The purchasing agent of the National Manufacturing Company has ordered certain goods from the United States Steel Company. The invoice for these goods is received by the mail department of the National Manufacturing Company. What disposition should be made of this invoice by the mail department?

6

The purchasing department of the American Steel Company receives from the mail department of the company an invoice for goods previously ordered. What disposition should be made of this invoice by the purchasing department?

7

In what form may orders for merchandise be received?

8

The Commercial Text Book Company receive an initial order for books from the Western Sales Agency. Explain what would probably be done with this order before it is sent to the billing department for the making of the invoice.

9

When this order reaches the billing department it may be assumed that four copies of the invoice will be made. Explain the probable disposition of each copy of the invoice.

10

After the invoices have been made the shipping department is notified to send the books ordered to the Western Sales Agency. Explain the methods which may be used in sending these books.

11

If the Commercial Text Book Company are doubtful in regard to the credit standing of the Western Sales Agency, but do not desire to delay the shipping of the books, what method may they follow so that the books may be sent at once and yet the company be protected from loss in connection therewith?

12

Explain some of the most important forms in which cash may be received, and what disposition should be made of all cash received.

13

The King Retail Company make frequent cash sales. Explain how the cash received from these sales may be verified daily.

14

If all cash receipts are deposited daily in the bank, explain the method by which cash receipts and deposits may be verified both daily and monthly.

15

It is desirable that only disbursements by check should be recorded in the cash disbursements journal. If this method is followed, explain how petty disbursements for which it is not desirable to issue a check may be made.

16

Explain the method of establishing and operating a petty cash fund.

17

The Taylor Wholesale Jewelry Company receive notes frequently from customers in the payment of merchandise, and issue notes

payable quite frequently to creditors in payment of merchandise purchased. Both the notes received and issued are recorded in the general journal. It is necessary, however, from time to time, to have information with reference to these notes which can not be conveniently shown by the journal entry. It is also inconvenient to refer to the notes themselves to obtain this information. Explain a method by which this information may be made available.

18

Explain and illustrate the use of a trade acceptance.

19

W. O. Crosswhite & Co., of Toledo, O., sell $500.00 worth of merchandise to A. P. Meritt, of Kansas City, terms 30 days, with the agreement that Meritt will accept a trade acceptance. The trade acceptance is drawn on Meritt by Crosswhite & Co., is accepted by the former, and returned to the latter. At the end of thirty days the acceptance is paid by Meritt. Explain all the entries involved in the foregoing transaction.

20

On the Balance Sheet of the Chicago Wholesale Grocery Company the following items appear:

Notes Receivable	$5,000.00
Trade Acceptances	1,000.00

On the Balance Sheet of the St. Louis Wholesale Grocery Company the following items appear:

Notes Receivable	$1,000.00
Trade Acceptances	5,000.00

With reference to these items, which Balance Sheet would you consider the more favorable?

LABORATORY MATERIAL

Practice Set No. 3—Continued

January 7

Paid the Stein Printing Co. $45.00 for office supplies. Debit Office Supplies.

Cashed a check for $50.00 and purchased stamps to be used for mailing letters. Debit Office Supplies.

Paid the Dunham Advertising Agency $100.00 to apply on account of a year's contract for advertising. Debit Selling Expenses.

Sold Central Hardware Co., 555 Milton St., City, terms 2/10, n/60, merchandise per carbon copy of our sales invoice No. 2, $133.80.

January 8

Paid Paul K. Humphrey $75.00 traveling expenses incurred in visiting prospective customers. Debit Selling Expenses.

Bought from Wickwire Brothers, Cleveland, merchandise per purchases invoice No. 3, terms 2/10, n/60, $2,691.20.

January 9

Bought from Universal Caster Co., St. Louis, merchandise per purchases invoice No. 4, terms 2/10, n/30, $1,837.50.

Sold Johnson Brothers, Kankakee, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 3, $182.53.

January 10

Withdrew $61.00 from the bank to be used in paying the following: stenographer's salary for the week, $25.00; shipping clerk's salary, $30.00; Mr. Long, $6.00, to reimburse him for expenses incurred in entertaining Mr. Johnson, of Johnson Bros., who was in the city on a buying trip and who gave us the order for sales invoice No. 3.

Debit Administrative Expenses for the first item, Receiving and Shipping Expenses for the second item, and Selling Expenses for the last item.

Sold Daniels & Hayden, Woodstock, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 4, $30.17.

January 12

Purchased for cash from the Globe Furniture Company, a filing case for use in the office, $50.00.

Sold F. L. Perkins, Michigan City, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 5, $108.35.

January 13

Paid J. F. Reinhart Manufacturing Co. for invoice received January 3d, less discount.

Bought from W. D. Allen & Co., Cleveland, Ohio, merchandise per purchases invoice No. 5, terms 3%, 30-day Trade Acceptance, $2,008.78. These terms indicate that 3% may be deducted if a 30-day Trade Acceptance is accepted when the merchandise is delivered.

Sold Gregg Hardware Co., Rochester, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 6, $36.00.

January 14

Accepted 30-day Trade Acceptance payable at Merchants' National Bank in payment for invoice purchased from W. D. Allen & Co., January 13th, less discount as per terms.

Enter in the journal and notes payable book. Credit Notes Payable for the trade acceptance.

Paid Barker & Co., $85.00 for packing cases purchased from them and delivered today. Debit Shipping Supplies.

Sold T. W. Richardson, Warren, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 7, $48.22.

January 15

Paid Henry Disston & Co. for invoice received January 5th, less discount.

An agreement was made previously with the Sloan Transfer Co. by which they are to do all the hauling and drayage in connection with merchandise purchased and sold. They are also to pay all freight on goods received and are to present their bill for freight and drayage twice each month. Accordingly, this company presented their bill for the first fifteen days of January; this is itemized as follows: inward freight paid, $95.75; hauling inward freight, $34.25; hauling outward freight, $55.60; total, $185.60. Paid Sloan Transfer Co. $185.60, amount of bill rendered.

Make three entries in the cash book. If the business papers are used, indicate the check number in the "Explanation" column for each entry; this facilitates auditing.

Sold A. W. White, Paxton, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 8, $26.38.

Paid Thompson Brothers $600.00 for store equipment purchased on January 5th.

January 16

Received a check from Fred Dole in payment of merchandise sold him January 6th, less discount.

Sold W. H. Stevens, McHenry, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 9, $44.45.

January 17

Withdrew $165.00 from the bank to pay the following: weekly pay-roll, $55.00; Humphrey, $50.00 for personal use; Long, $60.00 for personal use.

Received from Central Hardware Co. their check for $32.12 and their note dated January 16th, due in 60 days, payable at Merchants' National Bank, for $100.00, in payment of merchandise sold them January 7th, less discount as per terms of the sale, and plus $1.00 interest on the note at 6% for 60 days.

Make the entry for the note in the journal and notes receivable book, and for the check, discount, and interest in the cash book.

Sold A. L. Burton, Elgin, terms 3%, 60-day Trade Acceptance, merchandise as per carbon copy of our sales invoice No. 10, $146.04.

The terms in this sale indicate that if Burton will accept a trade acceptance payable in 60 days upon receipt of the merchandise, he may deduct a discount of 3%, otherwise the terms are net 60 days.

Paid Wickwire Brothers for invoice received January 8th, less discount.

January 19

Employed stock clerk beginning work today at a salary of $20.00 per week. The principal duty of the stock clerk will be to arrange stock so that it can be easily obtained for shipment. Consequently, his salary will be treated as a selling expense.

Bought from Russel Erwin Co., Chicago, terms 2/10, n/60, merchandise per purchases invoice No. 6, $1,388.52.

Paid Universal Caster Company for invoice received January 9th, less discount.

Received check from Johnson Brothers, in payment of merchandise sold them January 9th, less discount.

January 20

Received from A. L. Burton a 60-day trade acceptance payable at the First National Bank of Elgin in payment of merchandise purchased on the 17th, less 3% discount.

Enter in the journal and notes receivable book. Debit the Notes Receivable account for the trade acceptance.

Returned to Russel Erwin Co., for credit, a part of the merchandise purchased January 19th, $62.46. Enter in the journal.

Sold A. P. Barlow, Gilman, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 11, $116.75.

January 21

Bought of Henry Disston & Co., Philadelphia, terms 2/10, n/60, merchandise per purchases invoice No. 7, $375.50.

Sold James W. Shore, Champaign, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 12, $64.96.

January 22

Received check from F. L. Perkins in payment of merchandise sold him January 12th, less discount.

Paid Horder Stationery Co. $37.75 for office supplies.

Issued a credit bill to A. P. Barlow for a part of the merchandise purchased by him January 20th, and returned for credit:

¼ doz. sets	12	Stove Casters	$16.15	$4.04
1 keg	8	Common Nails	4.00	4.00
				$8.04

Enter in journal.

Sold Fred Dole, Clinton, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 13, $126.50.

Prove cash; balance $9,496.47.

(Continued on Page 376)

CHAPTER XXVII

ACCRUALS AND DEFERRED ITEMS

Need for Consideration

At the end of the fiscal period there are certain items that do not appear on the ledger which must be considered if a true statement of the financial condition of the business is to be obtained. There may be items not shown in the accounts which are rightfully considered as assets or liabilities and there may also be items shown as expenses in the accounts which do not represent expenses of the current fiscal period. The items which must be considered at this time may be classified as follows:

1. Accrued Income.
2. Accrued Expenses.
3. Deferred Charges to Expense.

Accrued Income

Income may be earned in one fiscal period which is not due and payable until the subsequent period. Accurate accounting demands that each period be given credit for the income earned during the period, whether it is collected then or later. To illustrate: On November 1st, the business receives from a customer a note for $500.00, due in four months with interest at six per cent. On December 31st, one-half of this interest has been earned; that is, one-half of the service (use of the money) for which the interest is to be received has been performed. If the books are closed at this time (December 31st), one-half of the interest, or $5.00, should appear on the Balance Sheet as an asset, and it should also appear on the Statement of Profit and Loss as income earned during the current period.

If this item of accrued interest is to be shown on the Balance Sheet and the Statement of Profit and Loss, it must also be shown in the accounts. This is accomplished by debiting some asset account, which in this case may be termed Accrued Interest on Notes Receivable, and crediting the income account, Interest Earned. To

illustrate: It may be assumed that $48.00 has been *received* as interest on notes receivable during the year, and that the $5.00 mentioned above is the total interest accrued on notes receivable at the end of the year, in which case the two accounts affected by the item of accrued interest will appear as follows:

Interest Accrued on Notes Receivable

1920											
Dec.	31			5	00						

Interest Earned

						1920					
						Feb.	20			3	80
						June	10			12	20
						Aug.	1			18	12
						Nov.	6			13	88
						Dec.	31			5	00

When the closing entries are made on December 31st, the Interest Earned account will be closed into the Profit and Loss account. After it is closed it will appear as follows:

Interest Earned

1920						1920					
Dec.	31	Profit and Loss		53	00	Feb.	20			3	80
						June	10			12	20
						Aug.	1			18	12
						Nov.	6			13	88
						Dec.	31			5	00
				53	00					53	00

On March 1st, the customer who owes the $500.00 note mentioned in the illustration, will pay $10.00 interest when he pays the note. This interest will be credited to the Interest Earned account, but only one-half of it represents interest earned during the period when received, for one-half of it has been earned in the preceding period. In order to indicate this the Accrued Interest account is closed into the Interest Earned account after the closing entries have been made. These two accounts will then appear as follows:

Interest Accrued on Notes Receivable

1920						1920					
Dec.	31			5	00	Dec.	31			5	00

Interest Earned

1920					1920				
Dec.	31	Profit and Loss		53 00	Feb.	20			3 80
					June	10			12 20
					Aug.	1			18 12
					Nov.	6			13 88
					Dec.	31			5 00
				53 00					53 00
Dec.	31			5 00					

When the $10.00 interest is received on March 1st, it will be credited to the Interest Earned account and the difference between the credit item of $10.00 and the debit item of $5.00 will give the proper amount of interest to be treated as income earned during the current period.

The foregoing discussion of the treatment of accrued interest serves to illustrate the method of handling items of accrued income in general. In some cases where such items are numerous, one asset account, termed Accrued Income account, may be set up, to which all items of accrued income are debited instead of setting up separate asset accounts such as Interest Accrued on Notes Receivable.

Accrued income items are shown on the Balance Sheet as current assets.

Accrued Expenses

In the same manner that the records should show at the end of the fiscal period all the income earned during that period, they should also show a liability for all services which have been received during the period, though this liability may not be due until the subsequent period. Accrued expenses are expenses which have accrued or accumulated at the end of the fiscal period, but which are not payable until some time later. For instance, a business firm may pay its employes their weekly wages on Saturday. If its fiscal period ends on Wednesday, it will owe its employes their wages for three days, but they are not payable until three days later. These *accrued wages* should be shown as a liability on the Balance Sheet and as an expense of the current period on the Statement of Profit and Loss.

If this item of accrued wages is to be shown on the Balance Sheet and the Statement of Profit and Loss, it must also be shown in the accounts. This is accomplished by debiting some expense account such as Salaries of Sales Clerks and crediting the liability account Accrued Wages. To illustrate: It may be assumed that the account with Salaries of Sales Clerks shows a balance of $1,816.00 at the

end of the year and that the accrued wages of clerks amount to $28.00, in which case the two accounts affected by the item of accrued wages will appear as follows:

Salaries of Sales Clerks

1920										
Dec.	31	Balance		1,816	00					
	31	Accrued Wages		28	00					

Accrued Wages

						1920				
						Dec.	31		28	00

When the closing entries are made on December 31st, the Salaries of Sales Clerks account will be closed into the Profit and Loss account. After it is closed, this account will appear as follows:

Salaries of Sales Clerks

1920						1920				
Dec.	31	Balance		1,816	00	Dec.	31	Profit and Loss	1,844	00
	31	Accrued Wages		28	00					
				1,844	00				1,844	00

On January 3rd, $56.00 will be paid to the sales clerks and the Salaries of Sales Clerks account will be debited for this amount. Only half of this amount, however, represents an expense of the period when paid, for the other half has been charged as an expense of the previous period. In order to show this the Accrued Wages account is closed into the Salaries of Sales Clerks account after the closing entries are made at the end of the period. These two accounts will then appear as follows:

Salaries of Sales Clerks

1920						1920				
Dec.	31	Balance		1,816	00	Dec.	31	Profit and Loss	1,844	00
	31	Accrued Wages		28	00					
				1,844	00				1,844	00
						Dec.	31		28	00

Accrued Wages

1920						1920				
Dec.	31			28	00	Dec.	31		28	00

When the $56.00 wages is paid to the sales clerks on January 3, 1920, it will be debited to Salaries of Sales Clerks account, and the difference between the debit item of $56.00 and the credit item of

$28.00 will show the proper amount to be treated as an expense of the year 1920.

The foregoing discussion of the treatment of accrued wages serves to illustrate the method of handling items of accrued expenses in general. In some cases when such items are numerous one liability account, termed Accrued Expense account, may be set up, to which all items of accrued expenses may be credited instead of setting up separate liability accounts such as Accrued Wages. Accrued expense items are shown on the Balance Sheet as current liabilities.

It will be understood, of course, that all entries with reference to accrued income and accrued expenses are made in the journal at the time the other adjusting entries are made at the end of the fiscal period. The accounts with the entries made in them are shown in the foregoing illustrations merely for simplicity.

Deferred Charges to Expense

Deferred charges to expense are expenses paid in one period which are chargeable in part to the subsequent period. Consequently they are frequently termed *prepaid expenses.* The prepaid expenses which may arise in connection with businesses of different types are of various kinds. For purpose of illustration prepaid insurance and office supplies will be taken. The method employed in handling all such items is materially the same. The discussion of the treatment of prepaid insurance and office supplies as given below is sufficient to indicate the procedure in connection with all prepaid expenses.

Where there is a possibility of property being destroyed by fire or other accidental causes, the owner should be protected against such loss by insurance. To secure this protection it is necessary to enter into a contract with an insurance company by which the company agrees to indemnify the owner in case of loss and the latter agrees to pay the former a certain sum in return for the protection afforded by this contract. This contract, which is a more or less formal document, is known as the *insurance policy* and the compensation paid to the company to induce them to enter into this policy is known as the *insurance premium.* The insurance policy is made for a definite period of time, usually one year, and the premium is payable in advance.

Since a business firm usually has several policies, entered into at different times, with different companies, and covering different risks, it is desirable to have them entered in an *insurance policy record* which may be ruled as in Illustration No. 39.

INSURANCE POLICY RECORD

Date of Policy	No	Name of Company	Property Insured	Amount	Expires	Total Premium	
1916							
Jan 15	21692	Royal	Stock	2000	Jan 15, 1917	29	80
Mar 30	390	[illegible] Underwriters	Office Equip	3000	Mar 30, 1917	44	70
May 5	15321	Preferred Accident	Delivery	1500	May 5, 1917	22	35
July 16	16938	Standard	Stock	5000	July 16, 1917	74	50

Illustration No. 39—Left Page of Insurance Policy Record

At the time the insurance policy is obtained it is entered in the insurance policy record and the amount of the premium applicable to each of the remaining months of the current year is shown in the proper column. The amount not chargeable to the current fiscal period is shown in the last column. At the same time that the policy is entered in the insurance policy record the amount of the premium paid is debited to a Prepaid Insurance account.

Prepaid Insurance Account

The purpose of the Prepaid Insurance account is to show the cost of the insurance in force. It is charged with all premiums paid. At the end of the month the amount of the insurance expired is determined by obtaining the total of the column for that month as shown by the insurance policy record. The Prepaid Insurance account is credited for the amount of the insurance expired and the proper expense account debited. For instance, insurance on merchandise would be debited to Selling Expenses, on delivery equipment to Delivery Expenses, and on buildings and office equipment to Administrative Expenses. The debits and credits to the Prepaid Insurance account may be stated as follows:

Prepaid Insurance

DEBIT:	CREDIT:
With all amounts paid for insurance premiums.	With insurance premiums refunded on cancelled policies. At the end of the month with expired insurance as shown by the insurance policy record.

The balance of this account after the credits have been entered shows the amount of the unexpired insurance. It is shown on the Balance Sheet as a deferred charge to expense.

At the beginning of the next year the insurance policy record will be ruled so as to close out the amounts of the previous year and the unexpired policies will be entered again with amounts shown in the last column carried forward and distributed over the months to which they pertain.

INSURANCE POLICY RECORD.

Monthly Expirations												Amount Carried Forward
Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	
2.48	2 48	2 48	2 48	2 48	2.48	2.48	2.48	2.49	2.49	2.49	2 49	
			3 72	3.72	3 72	3.72	3.72	3 72	3.73	3.73	3.73	11.19
				186	186	186	186	1.86	1.86	1.86	1.86	7 47
						6.20	6 20	6.21	6.21	6 21	6.21	37.26

Illustration No. 39—Right Page of Insurance Policy Record

Office Supplies Account

Office supplies may include such items as stationery, pencils, pens, paper clips, etc. The purpose of the account with Office Supplies is to show the cost of such articles purchased, the amount used, and the amount on hand at the end of the period.

The debits and credits to this account are as follows:

Office Supplies

DEBIT:	CREDIT:
With the cost of all office supplies purchased during the period.	With the cost of all the supplies used during the period.

At the time this account is credited for the cost of supplies used, some expense account, generally Administrative Expense, is debited. Usually it is difficult to keep a record of the supplies used, so an inventory is taken at the end of the period and the amount of the inventory subtracted from the debit side of the Office Supplies account to obtain the cost of the supplies used. The amount thus obtained is credited to the account, leaving, therefore, a balance in the account which equals the inventory on hand. This balance is shown on the Balance Sheet as a deferred charge to expense.

Additional Expense Accounts

As indicated by the introduction in the preceding discussion of the Salaries of Sales Clerks account, the employment of other expense accounts than those discussed in Chapter XXIII may often be desirable. For instance, the salaries of sales clerks may be recorded in the Selling Expense account, but if the selling expenses are large and varied it may be desirable to have an analysis of them and therefore separate accounts such as the Salaries of Sales Clerks account will be set up. From henceforth additional expense accounts will be introduced from time to time in the discussions and the laboratory exercises. In each case the purpose of the account and its classification will be explained, but the bookkeeping details with reference to its construction will not be discussed.

QUESTIONS FOR CLASS DISCUSSION

1

On December 1, 1919, James Arnold receives from a customer a sixty-day note for $500.00 with interest at six per cent. Explain the entries which should be made with reference to this note if Arnold's fiscal period ends on December 31st.

2

Explain how the interest accrued on this note will be shown on the Balance Sheet of Arnold made on December 31, 1919.

3

On February 1st the customer pays Arnold this note with interest. Explain the entries which will be made on this date and explain the method employed to prevent the showing of the total interest received as an earning of the year 1920.

4

The McNeal Wholesale Company pay their sales clerks at the end of each two weeks. The last payment was made on December 24th. The company's fiscal period ends on December 31st. Explain the entries which will be necessary in connection with the salaries of sales clerks on this date.

5

Explain the method of showing the accrued salaries of sales clerks on the Balance Sheet and the Statement of Profit and Loss of the company prepared on December 31st.

6

Explain the entries which should be made after the closing entries have been made and also the entries which will be made when the sales clerks are paid on January 7th.

7

Explain and illustrate the meaning of deferred charges to expense.

8

The Retail Mercantile Store secures a three-year insurance policy on its merchandise stock on July 1, 1919, paying in advance a pre-

mium of $500.00. Explain the entries which should be made in connection with this premium at the end of the fiscal period, December 31, 1919.

9

The Retail Mercantile Store has several insurance policies covering its stock in trade, furniture and fixtures, store building, and delivery equipment. Explain how it may keep a record so as to have readily available such detailed information as it desires with reference to these various policies.

10

The Adams Mercantile Company have in the past maintained only one account with selling expense to which they have debited all expenses in connection with the sale of merchandise. These expenses have now become so numerous that the company decide that it is desirable to have an analysis made. Explain what methods may be followed so that the accounts will provide this analysis.

LABORATORY MATERIAL

Practice Set No. 3—Continued

January 23

Received check for $64.00 from W. L. Peterson, Ogden, in payment for the following purchase made by him today: 2 doz. No. 82 pocket knives at $17.00; 1 doz. No. 2007 knives and forks, $30.00.

Enter in the sales journal in the same manner as a sale on account and in the cash book in the same manner as a cash receipt from a customer in payment for his account.

Bought of Johnstown Cutlery Co., Johnstown, terms 3%, 30-day Trade Acceptance, merchandise per purchases invoice No. 8, $2,355.60.

January 24

Received a check for $20.00 from the Drexel Storage Company in payment for packing cases which we sold them.

When these cases were purchased, their value was charged to the Shipping Supplies account. It is assumed that these cases are sold because they were damaged or an error was made in the specifications when the cases were purchased.

Withdrew $125.00 from the bank to pay the following: pay-roll for the week, $75.00; Long, for personal use, $25.00; Humphrey, for personal use, $25.00.

Bought of J. F. Reinhart Manufacturing Co., Liberty Mills, merchandise per purchases invoice No. 9, terms 2/10, n/60, $1,083.60.

January 26

Accepted 30-day trade acceptance payable at Merchants' National Bank in payment for invoice purchased from Johnstown Cutlery Co., January 23rd, less discount as per terms.

Gave the Williams Printing Company a check for $256.00 in payment for catalogs printed as per contract.

Since these catalogs will be mailed out at once, debit Selling Expenses.

Received checks as follows: T. W. Richardson, in payment of merchandise sold him January 14th; allowed him the discount, even though the discount date is past; W. H. Stevens, in payment of merchandise sold him January 16th, less discount.

Sold Gregg Hardware Company, Rochester, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 14, $91.93.

January 27

Gave Paul Humphrey a check for $46.00 in payment of traveling expenses incurred in selling.

Returned to J. F. Reinhart Manufacturing Co., Liberty Mills, a part of the merchandise purchased January 24th, $69.60.

Sold T. W. Richardson, Warren, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 15, $99.03.

Received check for $84.00 from I. W. Allen, Springfield, in payment for the following purchase made by him today: 2 doz. No. EE58 shovels at $13.50; 1 doz. No. 142 saw sets, $33.00; 6 kegs No. 8 common wire nails at $4.00. Enter in the same manner as the transaction of the same nature on January 23d.

January 28

The Gregg Hardware Company claimed that some of the post spades which we sold them January 26th were defective, and that they had to make allowances to customers to whom they sold them. We allow their claim for $10.00 and put in a claim for that amount against the J. F. Reinhart Manufacturing Co., from whom we bought the spades January 24th. Only one entry is required at this time.

Sold John Hartman, Grant Park, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 16, $26.59.

Bought of E. C. Simmons Hardware Company, St. Louis, merchandise as per purchases invoice No. 10, terms 2/10, n/60, $301.40.

January 29

Paid Russel Erwin Co., for merchandise purchased from them January 19th, less credit for merchandise returned and less discount.

Sold N. D. Norris & Sons, Kankakee, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 17, $76.30.

Gave Frank Long a check for $35.00 to cover his expenses incurred on a purchasing trip. Debit Buying Expenses.

January 30

Received a credit bill from J. F. Reinhart Mfg. Co. for $10.00, amount of claim which we put in on the 28th.

Sold Lang Brothers Hardware Company, Crown Point, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 18, $74.29.

Received check from A. P. Barlow in payment of merchandise sold him January 20th, less merchandise returned and less discount.

Sold A. W. White, Paxton, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 19, $37.65.

January 31

Sold Central Hardware Co., 555 Milton St., City, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 20, $41.38.

Bought of E. C. Simmons Hardware Co., St. Louis, merchandise per purchases invoice No. 11, terms 2/10, n/30, $460.29.

Gave Sloan Transfer Co. a check for $103.95 in payment for the following: inward freight paid, $58.25; hauling inward freight, $21.00; hauling out freight, $24.70.

Cashed a check at the bank to pay the following: weekly pay roll, $75.00; Long, $40.00 for personal use; Humphrey, $30.00 for personal use.

Paid Henry Disston & Co. for merchandise purchased from them January 21st, less discount.

Credit Long with $175.00 and Humphrey with $150.00, salary of each for the month of January.

Enter in the journal; debit Administrative Expenses for Long's salary, and Selling Expenses for Humphrey's salary.

Instructions: 1. Prove cash (balance $7,483.35) and rule the cash book.

2. Post all books of original entry.

3. Take a Trial Balance of the general ledger.

4. Make a list of the Customers' and Creditors' accounts as shown by the subsidiary ledgers and compare with the controlling accounts.

CHAPTER XXVIII

THE ADJUSTING AND CLOSING ENTRIES

Need for Consideration

The life of a business is divided into certain periods of time, known as *fiscal periods.* A fiscal period may be any length of time desired and in practice it varies from one month to one year. Formerly it was customary to make the fiscal period one year. The present tendency in some lines of business is to make it a shorter period of time. At the end of the fiscal period the Balance Sheet and the Statement of Profit and Loss are made and a summary of the period's operations is made in the accounts. Such a summary is known in accounting as "closing the ledger."

Before the ledger summary is made it is necessary to make certain adjustments in order that the accounts may reflect the correct financial condition of the business. The fixed asset accounts must be adjusted to show the depreciation which has accumulated during the period; the estimated loss on bad debts must be entered; the accrued income and accrued expenses must be recorded and the deferred charges to expense must be shown in the proper accounts. In order to show all these adjustments, certain adjusting entries must be made at the end of the fiscal period.

The Working Sheet

The Trial Balance shows the condition of the ledger after all the current transactions of the period have been entered. After the Trial Balance is obtained, the adjustments stated in the preceding paragraph must be made before the Balance Sheet and the Statement of Profit and Loss are prepared and the closing entries recorded. In order to make these adjustments more readily the accountant frequently employs the *working sheet.* It consists of the Trial Balance and usually six additional columns. The purpose of these columns is indicated by the headings shown in the following form:

Working Sheet

Trial Balance		Adjustments		Profit & Loss		Balance Sheet	
Debits	Credits	Debits	Credits	Expenses	Income	Assets	Liabilities

The first two columns show the Trial Balance as taken from the books. The next two columns headed "Adjustments" show the adjustments necessary to make the accounts reflect the present financial condition of the business. The two columns headed "Profit and Loss" show the accounts which will appear on the Statement of Profit and Loss, and the last two columns show the items which will appear on the Balance Sheet.

Illustration of the Working Sheet

In order to illustrate the use of the Working Sheet the following Trial Balance is given:

W. H. SPENCER
Trial Balance, December 31, 192

Cash	$450.00	
Notes Receivable	200.00	
Accounts Receivable	3,846.00	
Reserve for Bad Debts		$380.00
Merchandise Inventory	4,200.00	
Furniture and Fixtures	800.00	
Reserve for Depreciation of Furniture & Fixtures		160.00
Buildings	2,200.00	
Reserve for Depreciation of Buildings		220.00
Land	1.200.00	
Notes Payable		1,640.00
Accounts Payable		2,600.80
W. H. Spenecr. Proprietor		7,116.60
W. H. Spencer, Personal	120.00	
Sales		18,000.00
Purchases	11,000.00	
Buying Expenses	408.70	
Delivery Expenses	749.00	
Selling Expenses	1,940.00	
Administrative Expenses	2.264.20	
Insurance	380.00	
Office Supplies	105.00	
Purchases Discount		340.00
Sales Discount	471.50	
Interest Earned		25.00
Interest Paid	148.00	
	$30,482.40	$30,482.40

Supplementary Data

1. *Inventories*

   Merchandise Inventory, December 3, 1920, $4,860.00

2. *Depreciation*

   Furniture and Fixtures, 10%

   Buildings, 5%

3. *Deferred Charges*

   Insurance Unexpired, $84.00

   Office Supplies, $57.00

4. *Accrued Income*
   Interest on Notes Receivable, $3.20
5. *Accrued Expenses*
   Salaries of Sales Clerks, $52.00
6. *Reserve for Bad Debts*
   One Per Cent. of Accounts Receivable

The Adjusting Entries

The entries necessary to make the adjustments required to give effect to the supplementary data stated above are as follows:

December 31, 192

	Purchases	$ 4,200	00		
	Merchandise Inventory			$ 4,200	00
	To close the beginning inventory into Purchases account.				
	31				
	Merchandise Inventory	4,860	00		
	Purchases			4,860	00
	To enter the inventory of December 31, 1920.				
	31				
	Administrative Expenses	190	00		
	Reserve for Depreciation of Furniture and Fixtures			80	00
	Reserve for Depreciation of Buildings.			110	00
	To enter yearly depreciation on furniture and fixtures and buildings.				
	31				
	Administrative Expenses	296	00		
	Insurance			296	00
	To enter the insurance expired during the year.				
	31				
	Administrative Expenses	48	00		
	Office Supplies			48	00
	To charge to administrative expenses the value of office supplies used during the year.				
	31				
	Interest Accrued on Notes Receivable	3	20		
	Interest Received			3	20
	To record the interest accrued on notes receivable.				
	31				
	Selling Expenses	52	00		
	Wages Accrued			52	00
	To record accrued wages of sales clerks.				
	31				
	Selling Expenses	38	46		
	Reserve for Bad Debts			38	46
	To record the estimated loss on uncollectible accounts.				

When these entries have been posted to the Working Sheet, it will appear as in Illustration No. 40.

W. H. SPENCER

Working Sheet, December 31, 192..

Name of Account	Trial Balance Debits	Trial Balance Credits	Adjustments Debits	Adjustments Credits	Profit and Loss Expenses	Profit and Loss Income	Balance Sheet Assets	Balance Sheet Liabilities
Cash	450 00						450 00	
Notes Receivable	200 00						200 00	
Accounts Receivable	3846 00						3846 00	
Res. for Bad Debts		380 00		38 46				418 46
Mdse. Inventory	4200 00		4860 00	4200 00			4860 00	
Furn. and Fixt.	800 00						800 00	
Res. Depr. on F. & F.		160 00		80 00				240 00
Buildings	2200 00						2200 00	
Res. Depr. on Bldgs.		220 00		110 00				330 00
Land	1200 00						1200 00	
Notes Payable		1640 00						1640 00
Accounts Payable		2600 80						2600 80
W. H. Spencer, Prop.		7116 60						7116 60
W. H. Spencer, Per.	120 00						120 00	
Sales		18000 00				18000 00		
Purchases	11000 00		4200 00	4860 00	10340 00			
Buying Expenses	408 70				408 70			
Delivery Expenses	749 00				749 00			
Selling Expenses	1940 00		52 00 38 46		2030 46			
Administrative Exp.	2264 20		190 00 296 00 48 00		2798 20			
Insurance	380 00			296 00			84 00	
Office Supplies	105 00			48 00			57 00	
Purchases Discount		340 00				340 00		
Sales Discount	471 50				471 50			
Interest Received		25 00		3 20		28 20		
Interest Paid	148 00				148 00			
	30482 40	30482 40						
Int. Accrued on N. R.			3 20				3 20	
Wages Accrued				52 00				52 00
			9687 66	9687 66	16945 86	18368 20	13820 20	12397 86
Profits for Year					1422 34			1422 34
					18368 20	18368 20	13820 20	13820 20

Illustration No. 40—Working Sheet

The Statement of Profit and Loss

After the adjusting entries are posted to the adjustment columns of the Working Sheet the items representing expenses and incomes are extended into the columns headed "Profit and Loss," and the items representing assets, liabilities, and proprietorship are extended into the columns headed "Balance Sheet." From the items appearing in the "Profit and Loss" columns, a Statement of Profit and Loss can be prepared which will be as follows:

W. H. SPENCER

Statement of Profit and Loss for Year Ending December 31, 192..

Sales			18000	00
Cost of Goods Sold:				
Inventory Jan. 1, 192.	4200	00		
Purchases	11000	00		
	15200	00		
Less: Inventory Dec. 31, 192.	4860	00	10340	00
Gross Profit on Sales			7660	00
Operating Expenses:				
Buying Expenses	408	70		
Delivery Expenses	749	00		
Selling Expenses	2030	46		
Administrative Expenses	2798	20		
Total Operating Expenses			5986	36
Net Operating Profit			1673	64
Other Income:				
Purchases Discount	340	00		
Interest Received	28	20	368	20
Gross Income			2041	84
Deductions from Income:				
Sales Discount	471	50		
Interest Paid	148	00	619	50
Net Income			1422	34

Statement of Profit and Loss prepared from the Working Sheet Illustrated on Page 382

In the preceding chapters the discussion of the Balance Sheet appears first, and the Statement of Profit and Loss second. In this discussion the order is reversed. The arrangement in this discussion is not intended to fix the order in which these are to be prepared. Since the facts shown on the Working Sheet are used in the preparation of these statements, the accountant can take his choice as to which he wishes to prepare first. When the final reports are presented to the management, it is customary to place the Balance Sheet first.

The Balance Sheet

A Balance Sheet, in report form, prepared from the items in the "Balance Sheet" columns of the Working Sheet, will appear as in the illustration below. As stated in the paragraph at the bottom of page 383, the Balance Sheet may be prepared first if the accountant so desires.

W. H. SPENCER

Balance Sheet, December 31, 192..

Assets					
Current Assets:					
Cash		450	00		
Notes Receivable		200	00		
Accounts Receivable	3846.00				
Less: Reserve for Bad Debts	418.46	3427	54		
Merchandise Inventory		4860	00		
Int. Accrued on Notes Receivable		3	20		
Total Current Assets				8940	74
Fixed Assets:					
Furniture and Fixtures	800.00				
Less: Reserve for Depreciation	240.00	560	00		
Buildings	2200.00				
Less: Reserve for Depreciation	330.00	1870	00		
Land		1200	00		
Total Fixed Assets				3630	00
Deferred Charges to Expense:					
Office Supplies		57	00		
Prepaid Insurance		84	00		
Total Deferred Charges to Expense				141	00
Total Assets				12711	74
Liabilities and Proprietorship					
Current Liabilities:					
Notes Payable		1640	00		
Accounts Payable		2600	80		
Accrued Wages		52	00		
Total Current Liabilities				4292	80
Proprietorship:					
W. H. Spencer, Proprietor				8418	94
Total Liabilities and Proprietorship				12711	74

Balance Sheet prepared from the Working Sheet
Illustrated on Page 382

The Closing Entries

The entries necessary to provide a summary of the operations of the period as indicated by the Working Sheet and the Statement of Profit and Loss of Spencer are shown in the illustration at the top of page 385.

December 31, 192

		Dr.	Cr.
	Sales	10,340 00	
	Purchases		10,340 00
	To transfer the cost of goods sold to the Sales account.		
31			
	Sales	7,660 00	
	Profit and Loss		7,660 00
	To transfer the gross profit on sales to the Profit and Loss account.		
31			
	Profit and Loss	5,986 36	
	Buying Expenses		408 70
	Delivery Expenses		749 00
	Selling Expenses		2,030 46
	Administrative Expenses		2,798 20
	To close the operating expense accounts into the Profit and Loss account.		
31			
	Purchases Discount	340 00	
	Interest Received	28 20	
	Profit and Loss		368 20
	To close the non-operating income accounts into the Profit and Loss account.		
31			
	Profit and Loss	619 50	
	Sales Discount		471 50
	Interest Paid		148 00
	To close the non-operating expense accounts into the Profit and Loss account.		
31			
	Profit and Loss	1,422 34	
	W. H. Spencer, Proprietor		1,422 34
	To transfer the net profit for the fiscal period to the Proprietor's account.		
31			
	W. H. Spencer, Proprietor	120 00	
	W. H. Spencer, Personal		120 00
	To transfer the Personal account of the proprietor to his Capital account.		

If the foregoing entries are posted to Spencer's ledger and the accounts which balance properly ruled, only the asset accounts, the liability accounts, and the Proprietor's account will remain open. These accounts should correspond exactly with the Balance Sheet shown on page 384.

The Post-Closing Entries

In Chapter XXV it has been explained that, after the ledger has been closed at the end of the fiscal period, it is customary to transfer the accrued income accounts and accrued expense accounts to the income and expense accounts to which they pertain. In the ledger of W. H. Spencer there appears one accrued income account, Interest Accrued on Notes Receivable, and one accrued expense

account, Accrued Wages. The entries necessary to close these two accounts are as follows:

December 31, 192

		Interest Earned	3	20		
		Interest Accrued on Notes Receivable			3	20
		To close the interest accrued on notes receivable into the Interest Earned account.				
		31				
		Wages Accrued	52	00		
		Selling Expenses			52	00
		To close the Wages Accrued account into the Selling Expenses account.				

The Post-Closing Trial Balance

At the end of the fiscal period the equality of the debits and credits in the ledger is established by the Trial Balance. The adjusting, closing, and post-closing entries are then made. If these entries are made correctly the equilibrium of debits and credits should not be disturbed, since each entry consists of equal debits and credits. In order to prove the accuracy of these entries it is customary to take a second Trial Balance which is termed a *post-closing Trial Balance.* The post-closing Trial Balance of W. H. Spencer will be as follows:

W. H. SPENCER

Post-Closing Trial Balance, December 31, 192

	Cash	450	00		
	Notes Receivable	200	00		
	Accounts Receivable	3,846	00		
	Reserve for Bad Debts			418	46
	Merchandise Inventory	4,860	00		
	Furniture and Fixtures	800	00		
	Reserve for Depreciation of Furniture & Fixtures			240	00
	Buildings	2.200	00		
	Reserve for Depreciation of Buildings			330	00
	Land	1,200	00		
	Notes Payable			1,640	00
	Accounts Payable			2,600	00
	W. H. Spencer, Proprietor			8,418	94
	Selling Expenses			52	00
	Office Supplies	67	00		
	Insurance	84	00		
	Interest Earned	3	20		
		13,700	20	13,700	20

After the post-closing Trial Balance is made the ledger is ready to receive the transactions for the next fiscal period.

QUESTIONS FOR CLASS DISCUSSION

1

The Jones Mercantile Company own the building in which their business is conducted. They maintain a delivery service, receive occasional notes from customers in payment of accounts, and issue notes through their local bank in order to obtain funds with which to pay creditors. State the items on their Trial Balance in connection with which adjustments will probably have to be made at the end of the fiscal period.

2

If these adjustments become quite numerous, what method may be followed in order to facilitate the making of them?

3

Explain the construction and use of the Working Sheet.

4

At the end of the fiscal period there is accrued interest of $5.20 on notes which The Jones Merchandise Company have issued to their local bank. Explain the entries which will be made to record this accrued interest and how this item will be shown on the Balance Sheet and Statement of Profit and Loss.

5

At the end of their fiscal year the Company estimate that their furniture and fixtures have depreciated $90.00 during the year and that their building has depreciated $150.00. Explain the entries which will be made to record this depreciation.

6

Explain how the depreciation on the furniture and fixtures and on the buildings of The Jones Mercantile Company will be shown on their Balance Sheet and Statement of Profit and Loss.

7

The Jones Mercantile Company have accrued wages to sales clerks to the amount of $48.00 at the end of the fiscal period. Explain the entries necessary to record this at the end of the fiscal period.

8

Explain the method of showing these accrued wages on the Balance Sheet and the Statement of Profit and Loss.

9

Explain and illustrate the purpose and method of making the post-closing entries.

10

Explain the purpose of the post-closing Trial Balance.

11

At the time of closing the books of the King Mercantile Company on December 31, 1919, the following adjustments are necessary:

(1) A reserve for depreciation on buildings is to be set aside for the year equal to two per cent. of the cost, $20,000.00.

(2) Office furniture costing $800.00 was purchased on July 1, 1918. It is estimated that it will be of service for ten years from date of purchase and will have a scrap value of $50.00.

(3) Interest accrued to date on notes receivable amounts to $6.85.

(4) Interest accrued to date on notes payable amounts to $17.90.

(5) On July 1, 1919, $150.00 of stationery was purchased and charged to Office Supplies account. One-half of this stationery is on hand at the end of the year.

(6) Insurance on building was taken out July 1st, for a period of one year, the premium being $80.000; when paid the premium was debited to Prepaid Insurance.

(7) On November 1st the firm's note for $2,000.00 was discounted at the Mercantile Trust Company at six per cent. for ninety days.

(8) The wages accrued from the last pay-day amount to $360.00. One-half of this is chargeable to Administrative Expenses, one-fourth to Selling Expenses and one-eighth to Buying and Delivery Expenses respectively.

(9) The inventory of merchandise on December 31, 1919, is $6,240.00.

(10) The loss on bad debts for the past three years has averaged one per cent. of sales. The sales for the year are $100,000.00.

Give the entries which will be necessary to make these adjustments.

LABORATORY MATERIAL

Practice Set No. 3—Continued

Transactions for February

February 2

Employed E. D. Carpenter as traveling salesman at a salary of $40.00 a week and expenses. Advanced him $100.00 for traveling expenses.

Debit E. D. Carpenter. His account will be credited as he reports the money expended. Add his name to the pay roll list.

Sold T. W. Richardson, Warren, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 21, $95.68.

Purchased from the Dawson Mfg. Co. merchandise, as per our purchases invoice No. 12, $28.50; terms, net cash. Gave them check in payment.

Received check from Fred Dole, in payment of merchandise sold him January 22nd, less discount.

February 3

Gave Dunham Advertising Agency a check for $100.00 to apply on advertising contract. See entry for first payment on contract, January 7th.

Gave checks in payment of January bills as follows: City Gas & Electric Co., light, $22.60; People's Title & Trust Co., rent, $150.00; Bell Telephone Co., telephone service and telegrams, $26.85; Hydrox Co., water, $3.00.

Sold A. L. Burton, Elgin, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 22, $70.69.

Paid J. F. Reinhart Mfg. Co. for merchandise purchased from them January 24th, less returns and rebate, and less discount.

February 4

Gave Seitz Commercial Photography Co. a check for $40.00, in payment for work in connection with our catalog. Debit Selling Expenses.

T. W. Richardson returned for credit the following merchandise sold him February 2nd: ½ dozen EO255 furnace scoops, $4.00,

Sold J. B. Stebbins & Co., 1121 Sherman Ave., City, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 23, $61.25.

February 5

Sold Gregg Hardware Company, Rochester, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 24, $97.87.

Sold E. W. Burke & Company, Wheaton, terms 3%, 30-day Trade Acceptance, merchandise as per carbon copy of sales invoice No. 25, $185.34.

Received checks as follows: Gregg Hardware Company, in payment of merchandise sold them January 26th, less credit allowed for defective spades and less discount; T. W. Richardson, Warren, in payment of merchandise sold him January 27th, less discount.

February 6

Purchased from Wickwire Brothers, Cleveland, merchandise per our purchases invoice No. 13, terms 2/10, n/60, $385.00.

Sold Lang Brothers Hardware Co., Crown Point, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 26, $62.37.

February 7

Received check from John Hartman, in payment of merchandise sold him January 28th, less discount.

Received from E. W. Burke & Co. a 30-day trade acceptance, accepted February 6th, payable at the City National Bank of Wheaton, in payment for merchandise shipped them February 5th.

Cashed a check for $170.00 to pay the following: weekly payroll, $115.00; Humphrey, for personal use, $30.00; Long, for personal use, $25.00.

Gave E. C. Simmons Hardware Company a check in payment of merchandise purchased January 28th and 31st, less discount.

Sold A. P. Barlow, Gilman, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 27, $38.28.

February 9

Received checks as follows: N. D. Norris & Sons, in payment for merchandise sold them January 29th, less discount; Lang Brothers Hardware Co., in payment for merchandise sold them

January 30th, less discount; A. W. White, in payment for merchandise sold him January 30th, less discount.

E. D. Carpenter reports traveling expenses for the week, $32.50. Debit Selling Expenses and credit E. D. Carpenter.

Cashed a check for $10.00 and purchased stamps to be used in mailing catalogs. Debit Selling Expenses.

Sold John Hartman, Grant Park, terms 2/10, n/60, merchandise per carbon copy of sales invoice No. 28, $66.28.

February 10

Received an invoice from the Muskegon Motors Company for a two-ton truck which we purchased from them, price $1,375.00, delivered, terms 30-day trade acceptance. Enter in journal.

Returned to Wickwire Brothers 5 kegs of No. 16 common nails purchased from them February 6th, at $3.00 per keg.

Sales of merchandise, on account, as follows:

Lewis Hardware Company, Centralia, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 29, $47.84.

Fred Dole, Clinton, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 30, $63.75.

A. W. White, Paxton, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 31, $46.80.

February 12

Received check from T. W. Richardson, in payment of merchandise sold him February 2nd, less returns, and less discount.

Contracted with Henry Wilson for garage space for our truck at $25.00 a month, beginning February 13th. Gave him a check for $12.50, in payment for the remainder of February. Debit Delivery Expenses.

Sold Jackson Hardware Company, Jackson, terms 3%, 30-day trade acceptance, merchandise as per carbon copy of sales invoice No. 32, $56.28.

February 13

The motor truck purchased February 10th has been delivered and trade acceptance accepted as per terms.

Received a check from A. L. Burton, in payment for merchandise sold him February 3rd, less discount.

Gave the International Lloyds Co. a check for $24.00 in payment of premium for one year's insurance on the motor truck at the rate of $24.00 a year. Debit Prepaid Insurance.

Sold Victor Price & Co., Galesburg, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 33, $31.18.

Gave the Merchants' National Bank a check in payment for trade acceptance, accepted January 14th.

February 14

Received check from J. B. Stebbins & Co., in payment of merchandise sold them February 4th, less discount.

Bought from J. F. Reinhart Manufacturing Co., Liberty Mills, merchandise per our purchases invoice No. 14, terms 2/10, n/60, $604.20.

Withdrew $175.00 from the bank to pay the following: weekly pay-roll, $115.00; Humphrey and Long, each, $30.00 for personal use.

Received a 30-day trade acceptance from Jackson Hardware Co., accepted February 13th, payable at Merchants' Bank of Jackson, in payment of merchandise sold them February 12th, as per terms.

Sold W. H. Stevens, McHenry, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 34, $56.98.

Prove cash (balance $3,672.99).

(Continued on Page 406)

CHAPTER XXIX

CONSIGNMENTS AND C. O. D. SHIPMENTS

Definition

When a merchant ships goods to another party to be sold by him for the account of the shipper, the transaction is called a *consignment.* More technically a consignment may be defined as "goods delivered by the party of the first part to the party of the second part for the purpose of sale by the party of the second part for account of the party of the first part." It will be seen from the definition that two parties are involved in a consignment. The party who ships or consigns the goods is known as the *consignor*, and the party who receives the goods for sale is known as the *consignee.* Goods sent on consignment are termed *consignments-out* by the consignor, and are termed *consignments-in* by the consignee when received by him. Sometimes *consignments-out* are called *shipments.*

Relation of Consignor and Consignee

With reference to their dealings with each other the consignor and consignee have the relation of principal and agent and their actions are governed by the general rules of the law of agency. Each must comply with the contract which exists between them, and in the absence of a specific contract they are governed by the trade customs of the business in which they are engaged. The consignee, as agent of the consignor, must comply with the instructions of the latter so long as they are not inconsistent with the terms of their contract or the customs of the trade.

With reference to the goods the relation between the consignor and the consignee is that of bailor and bailee and is governed by the general rules of the law of bailments. Barring specific instructions or specific contract agreements, the consignee may conduct the consignment transactions for his principal on the same basis

and in the same general manner as he would conduct them if the goods were his own. He is expected to exercise the same care in handling the goods as if they were his own. So long as any part of the goods remain in the possession of the consignee he must exercise ordinary diligence in protecting and safeguarding them. He is not liable, however, for damage from unavoidable causes such as cyclones, destruction by unavoidable fire, and similar causes. What constitutes due diligence on the part of the consignee depends on the nature of the goods and the circumstances of the particular case. In general, the consignee is required to exercise the same degree of diligence in safeguarding the goods of his principal as an ordinary reasonable man would use in safeguarding his own goods.

The agent must keep the goods of his principal separate from his own goods and also the goods received from other consignors. If he mixes the goods of his principal with his own he does so at his peril. For instance, under such circumstances in case of partial loss the agent may be compelled to bear the entire loss on the assumption that the goods destroyed are his and not those of his principal, since he is unable to designate the latter.

Consignee's Lien on Consigned Goods

The consignee usually pays certain expenses in connection with the goods which he receives from the consignor. These include such items as freight, insurance, duty, handling charges, etc. The consignee in some cases makes advances or payments to the consignor prior to the sale of the goods. For all legitimate expenses incurred by the consignee and for all advances made to the principal he has a lien on the consigned goods. The consignor can not reclaim the consigned goods until he has satisfied the claims which the consignee has against them.

The consignee usually receives a commission in payment for his services in selling the goods. When the goods are sold he has the right to deduct from the proceeds all expenses incurred in connection with them and his commission, before remitting to the consignor. If the goods do not sell for sufficient to pay the expense incurred in connection with them the consignee has a claim against the consignor for the difference. It may be well to mention that the commission of the consignee is calculated on the gross sales and not on the net proceeds of the sales.

Advantages of Consignments

The practice of selling goods by means of consignments is not as prevalent at present as it was formerly, but it still prevails in some lines of business. Most of the live stock which is shipped to the stockyards in the large cities is shipped on consignment. A considerable portion of the produce shipped to the city markets is sold in the same manner. In some lines, for instance the live stock market, the present method of selling on consignment is due in large part to the circumstances existing at the time the live stock markets were first established. It has been the custom of the trade for so long that it continues after the original circumstances have changed.

In many lines of business, however, the consignment method of sale offers certain advantages to one or both parties. The consignor retains title to the goods until they are sold, and this may be an advantage in case the credit rating of the consignee is doubtful. At the present time when credit information is readily available this is not as important as formerly. In the case of perishable goods it is an advantage to the consignee to receive them on consignment, since it enables him to shift all damages in connection with the goods on to the consignor. In some lines of goods, like cigars, new brands are received on consignment while their merit is being determined, and this enables the dealer to shift to the producer the risk in connection with the attempt to introduce a new brand. As a consequence, it makes it necessary for the producer not only to produce an article of merit, but also to advertise it sufficiently to create a demand for it.

The Account Sales

After the consignee has sold the goods received from his principal, it is necessary that he render an accounting with reference to the sale. This accounting is usually rendered by means of a report known as an *account sales.* The account sales is somewhat similar in form to an invoice and contains a summarized statement of all transactions pertaining to a particular consignment. It shows the quantity of the goods received, the sales made, the expenses incurred, and the balance or net proceeds. The disposition of the proceeds is also indicated, whether remittance is being made or the amount placed to the credit of the consignor. The form of an account sales is shown in Illustration No. 41.

Account Sales

June 25 19__

M Rosenbeck & Williams   Address Springfield

Below please find account sales of 500 bales, 49561 lbs. Hay

Sold by C. W. KEELAND & CO.

Received June 11 19 __ *and sold for account of* yourselves

DATE		CHARGES	AMOUNT		DATE		SALES	AMOUNT	
6	15	Freight	59	47	6	16	200 bales, 20119 lbs. 14.00	140	83
	12	Other Charges Labor	2	50		21	290 " 28365 " 14.00	198	56
		Returns							
	25	Drayage	9	80					
		Storage	4	90			10 bales, 1077 lbs., too		
		Insurance	3	39			badly damaged to be sold.		
		Commission	16	97					
		Net Proceeds	242	36					
		Total	339	39			Total Sales	339	39
		Advances							
		Balance by check	242	36					

Illustration No. 41—Account Sales

Accounting for Consignments

Different methods are used in the recording of consignments, but the differences are in the main a matter of form, the final result being the same. In the discussion which follows only one method of recording consignments is discussed and illustrated. It is thought that it might be confusing to the beginning student if the various methods were discussed at this time. Later in the chapter references are given where full discussions may be obtained.

The Consignor's Record

The chief interest of the consignor is to determine the net proceeds of the consignment. At the time the goods are shipped there is no change in his financial condition unless certain expenses are incurred in connection with the shipment. The consignor still retains title to the goods and by the shipment he merely changes their location. Consequently, he makes no record of the shipment in his financial records. A copy of the invoice sent to the consignee will be filed as a memorandum of the transaction. In some cases an invoice of a different color is used in connection with consignment shipments in order to eliminate the possibility of confusion with the regular sales invoice. If any expenses in the way of packing, drayage, or insurance are incurred in connection with the consignment shipment which can be allocated directly to it, an account

will be opened which may be termed "Consignment Out (name of consignee) No. 1." This account will be debited with the expenses incurred at the time the consignment is made. When the consignee renders an account sales, the Consignment account will be credited and Cash debited if the consignee remits the proceeds. If the consignee does not remit in cash, Accounts Receivable, instead of Cash, will be debited for the net proceeds. In any case the balance of the Consignment account will show the net returns from the consignment shipment. This balance may be transferred to the Sales account or, if it is desired to keep the consignment sales separate, it may be transferred to a Consignment Sales account. At the end of the fiscal period this account will be closed the same as the Sales account.

Illustration of the Consignor's Entries

In order to illustrate the entries made on the records of the consignor the following simple consignment transaction may be used:

J. M. Rogers ships to R. B. Kester, to be sold on his account, one hundred articles of X commodity. Rogers pays $20.00 for drayage and $30.00 for insurance on the merchandise. Kester pays freight and drayage, $67.50, and charges $28.60 for storage. He sells the goods for $750.00, charges a five per cent. commission and remits the net proceeds of $616.40 by New York draft.

1. Roger's books at time of sending the merchandise to Kester:

Consignment out, R. B. Kester No. 1 . .	$50.00	
Cash		$50.00
Cartage $20, insurance $30, paid in cash.		

2. Roger's books at time the account sales is received from Kester:

(a) Cash	$616.40	
Consignment out, R. B. Kester No. 1		$616.40
To record net proceeds of consignment as shown by account sales of this date.		
(b) Consignment out, R. B. Kester No. 2	566.40	
Sales		566.40
To transfer net returns from consignment to the Sales account.		

Note: For the sake of convenience the foregoing entries are all shown in journal form.

The Consignor's Inventory

If the consignor's fiscal period ends prior to the receipt of an accounts sales in full settlement, the goods on consignment as shown by the consignment invoice on file must be included in his inventory. He still retains title to this merchandise until it is sold and it constitutes a part of his inventory the same as the merchandise in his stockrooms. In determining the value of consigned goods the expenses incurred in sending the goods to the new market may properly be included as a part of the cost.

The Consignee's Record

The consignee desires to keep such a record as will enable him to discharge his liability to his principal when the goods are sold, and will enable him to determine his earnings in connection with the consignment transaction. When the consignment is received the financial condition of the consignee is not affected thereby, so no entries in his general accounts need to be made. A memorandum record of the goods received is made and frequently this is made on a loose leaf duplicate record in such a manner that the original copy when completed will serve as an account sales.

If, as is usual, the consignee incurs certain expenses in connection with the consignment, these will be debited to a consignment account. Usually the name of the consignor and the number of the account are a part of the account title. When the goods are sold the commission of the consignee is debited to the Consignment account and credited to an income account termed Commissions Earned. If storage charges are made they would be debited to the consignment account and credited to a Storage Earned account. The receipts from the sale are credited to the Consignment account and debited to Cash or Accounts Receivable, as the case may be. The balance of this account now represents the liability of the consignee to the consignor. If the consignee remits in cash the Consignment account will be debited and the Cash account credited. If the proceeds are to remain to the credit of the consignor, the Consignment account will be debited and Accounts Payable credited.

The Commissions Earned and Storage Earned accounts will be closed into the Profit and Loss account at the end of the fiscal period.

Illustration of the Consignee's Entries

In order to illustrate the entries made on the records of the consignee the simple example given on page 397 in connection with the

illustration of the entries on the records of the consignor may be used.

1. Kester's books on receipt of the consignment:

Consignment out, J. M. Rogers No. 1	$67.50	
Cash		$67.50
Paid freight and drayage on consignment of J. M. Rogers.		

2. Kester's books when consignment is sold:

(a) Consignment out, J. M. Rogers No. 1	$ 66.10	
Commissions Earned . . .		$ 37.50
Storage Earned		28.60
Commission and storage charges on consignment of J. M. Rogers.		
(b) Cash	750.00	
Consignment out, J. M. Rogers No. 1		750.00
To record sale of the consignment of J. M. Rogers.		
(c) Consignment out, J. M. Rogers No. 1	616.40	
Cash		616.40
To record payment of proceeds of consignment No. 1 of J. M. Rogers.		

Note: For the sake of convenience all of the above entries are shown in journal form.

The Consignee's Inventory

At the end of the fiscal period the consignee must be careful not to include in his inventory any goods which he has received on consignment. He does not have title to these goods, consequently they do not represent an asset to him. The expenses which he has paid in connection with the consignment will be shown on his Balance Sheet, since they are in the nature of an account receivable.

Reference for Collateral Reading

The discussion of consignments given in this chapter gives the accounting procedure which is applicable to a business that ships

or receives only a small number of consignments. In a business doing an extensive commission business more elaborate records will be kept. A more complete discussion of consignment records and accounts will be found in "Principles of Accounting," by John Raymond Wildman, C. P. A., published by the William G. Hewitt Press, New York; and in "Accounting Theory and Practice," Vol. I, by Roy B. Kester, C. P. A., published by the Ronald Press, New York.

C. O. D. Sales

When a sale is made with the agreement that the purchaser is to pay for the merchandise when it is delivered, the terms are said to be *collect on delivery*, or as it is more frequently stated, *C. O. D.* The procedure of handling C. O. D. sales is somewhat different in a wholesale and a retail business, therefore it is necessary to discuss separately wholesale C. O. D. sales and retail C. O. D. sales.

Wholesale C. O. D. Sales

When C. O. D. sales are made at wholesale the customer usually lives in a different city from the seller and the goods are delivered to him by freight, express, or parcel post. It is necessary to notice the procedure in each case.

When a C. O. D. shipment is made by freight an order bill of lading is used. A sight draft is drawn on the purchaser and attached to the bill of lading. Usually the bill of lading with the attached draft is deposited with the local bank of the seller and the bank will transmit it to another bank in the city where the purchaser lives. The latter bank on receipt of the bill of lading with attached draft will notify the purchaser who by paying the draft can obtain the bill of lading which in turn entitles him to obtain the merchandise from the transportation company. The bank to whom the purchaser pays the draft transmits the proceeds to the original bank, which credits the seller with the proceeds.

When a C. O. D. shipment is made by express, the express company will not deliver it until the purchaser pays the transportation charges and the value of the shipment. An invoice is made for the amount of the shipment and enclosed in a special envelope provided by the express company. The envelope which is marked in large letters, "C. O. D.," accompanies the package. When it reaches its destination, the express company notifies the purchaser to call and receive it or delivers it to the purchaser. In either case, the pur-

chaser is required to pay the amount of the invoice plus the express charges before the package is delivered to him. The express company remits the amount of the invoice to the seller by its express money order, deducting a charge for issuing the money order, unless this charge has been collected from the purchaser. If the seller desires the purchaser to pay the charges for issuing the money order to be sent him in payment of the shipment, he must indicate this on the C. O. D. envelope. Illustration No. 42 shows the form of special envelope provided by the express company for containing the invoice for a C. O. D. shipment.

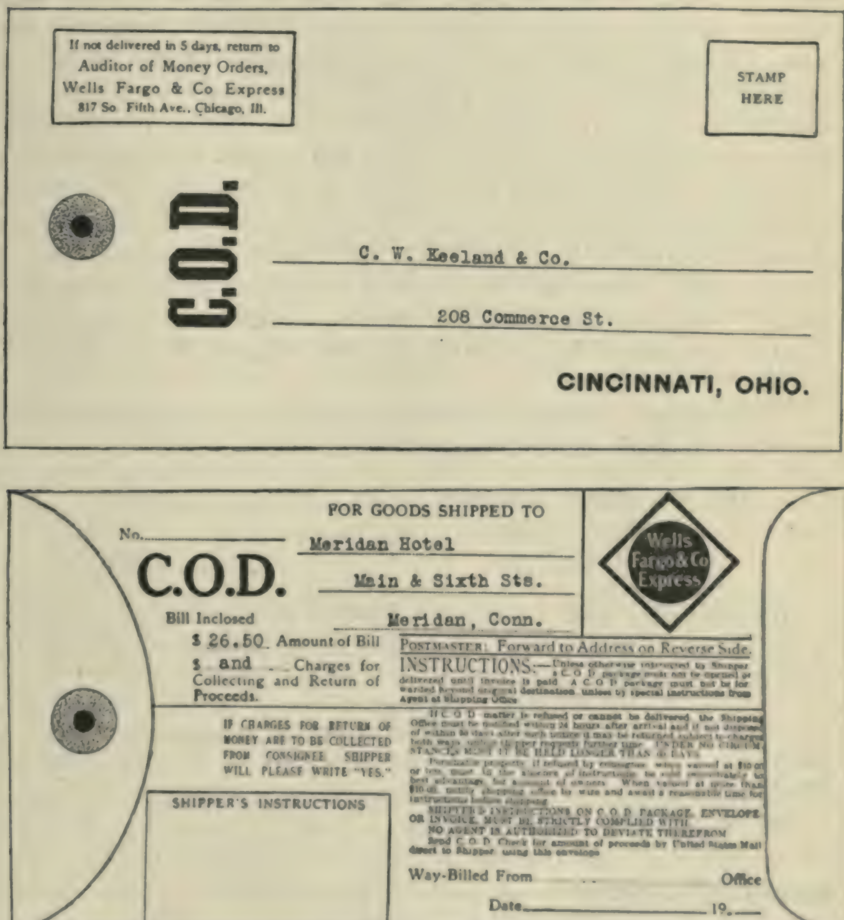


Illustration No. 42—Both Sides of a C. O. D. Envelope

When a C. O. D. shipment is made by parcel post, a special ticket, provided by the Post-office Department, is attached to the

package; this shows the amount to be collected before delivery is made. When delivery is made, the postmaster at the point of delivery mails the consignee a post-office money order for the amount shown on the ticket.

Accounting for Wholesale C. O. D. Sales

There must be some method of accounting for C. O. D. sales during the period intervening between the shipment of the goods and the receipt of the returns. The usual method is to debit such sales to Accounts Receivable and credit the Sales account in the same manner as other sales. In the customers' ledger instead of opening a separate account with each customer all such sales are debited to a C. O. D. account, the name of the customer being written in the explanation column. When the returns from the sale are received a credit is made to the C. O. D. account, the entry being made on the same line as the corresponding debit. The debit items which are not offset by a credit item, give the balance of the account at any time. Sometimes an account is opened in the subsidiary ledger with the transportation company instead of opening the C. O. D. account. It is used in the same manner as the C. O. D. account.

To illustrate: It may be assumed that W. H. Dinkins, wholesale jeweler, has made the following C. O. D. shipments:

Dec. 25.	James Anderson	$400.00
26.	Harvey Main	200.00
27.	H. B. James	380.00

On December 30th he receives $200.00 in payment of the shipment to Main. At the end of the month of December his C. O. D. account will appear as follows:

C. O. D.

1920						1920					
Dec.	25	J. Anderson		400	00						
	26	Harvey Main		200	00	Dec.	30	Harvey Main		200	00
	27	H. B. James		380	00						

Retail C. O. D. Sales

In the case of a retail business C. O. D. sales are delivered to the purchaser and the sales price collected by the delivery men of the store. Some stores have found by experience that a considerable number of C. O. D. deliveries are refused by the purchaser and are

returned to the store. In such cases it is preferable not to make any record of C. O. D. sales until delivery is made and collection for the sale made. In such cases the C. O. D. sales tickets are filed, but not entered until the collection has been made. The merchandise is turned over to the delivery department, where a memorandum record is made, charging the individual drivers for the C. O. D. packages given to them. At the end of the day the driver must return either cash or goods for the amount of the merchandise charged to him. The amount of the cash received is reported to the accounting department and an entry can be made the same as if the sales had been originally made for cash.

If the C. O. D. sales returned are not numerous, an entry may be made each day, debiting the Accounts Receivable account and crediting Sales on the main ledger and debiting a C. O. D. account in the subsidiary ledger. The cash received each day from C. O. D. deliveries will be debited to Cash and credited to Accounts Receivable and the C. O. D. accounts. The balance of the C. O. D. account at any time will show the amount of the merchandise sold C. O. D. which is in the hands of the delivery department. This amount can be verified by comparing it with the amounts charged to the drivers on the records of the delivery department.

If the latter method of recording C. O. D. sales is followed it will be necessary to make adjusting entries for C. O. D. deliveries which are refused. Such returns may be debited to Sales Returns, but it is probably preferable to debit them to the Sales account, since they are different from the usual returned sale. In any case, the Accounts Receivable and C. O. D. accounts must be credited for the goods returned.

It would seem to be more correct from a theoretical viewpoint to have the C. O. D. account on the main ledger and not to affect the Accounts Receivable account with C. O. D. sales. This would seem proper because the claims against customers in connection with C. O. D. sales are not the same as those which arise from sales on account. If C. O. D. sales, however, are to be recorded in the general sales record it is more convenient to have the C. O. D. account a subsidiary account so that the total of the sales in the Sales record can be posted to Accounts Receivable. Otherwise it is necessary to exclude the C. O. D. sales from the total in some manner. This may be done by having a separate column for C. O. D. sales. In this case the total of the sales on account column will be posted to Accounts Receivable, the total of the C. O. D. column will be posted to the C. O. D. account and the total of both columns credited to Sales.

QUESTIONS FOR CLASS DISCUSSION

1

Explain and illustrate the meaning of the terms consignment, consignor, and consignee.

2

What is the distinction between a consignment out and a consignment in.

3

James King & Co., of Chicago, ship merchandise to Henry Lee & Co., of New York, to be sold on consignment. Lee & Co. receive the goods, but instead of placing them in the warehouse where their own merchandise is kept, leave them where they are exposed to the weather. As a result the merchandise is damaged to a considerable extent. Can King & Co. recover damages from Lee & Co. for the injury to their merchandise? Why?

4

Assume that Lee & Co. receive the merchandise and place it in the warehouse with their own goods and that shortly thereafter the warehouse is destroyed by fire which originates in another building not owned by Lee & Co. Can King & Co. recover from Lee & Co. for the loss of the merchandise?

5

What is the usual way by which the consignee is reimbursed for selling the goods of the consignor?

6

If the consignee pays certain expenses, such as freight, insurance, drayage, etc., in connection with goods received from the consignor, how is he entitled to reimburse himself for these expenses?

7

What advantages may be derived from selling goods on consignment?

8

When a consignee has sold the goods of the consignor, in what way does he report to the latter?

9

Explain and illustrate the method of recording consignments on the records of the consignor.

10

Explain and illustrate the method of recording consignments on the records of the consignee.

11

In taking an inventory for James Madison & Co. you find that $500.00 worth of goods have been shipped on consignment to Henry Adams & Co. To date no account of sales has been received in connection with this consignment. Explain how you would treat these goods in connection with the inventory of Madison.

12

Assuming that you were taking the inventory of Adams & Co. and that the goods received from Madison are still on hand, how would you treat these goods in connection with the inventory of Adams & Co?

13

If Adams & Co. has paid $75.00 for freight and drayage on the goods of Madison & Co., how would you show this on their Balance Sheet at the end of the fiscal period?

14

Explain and illustrate the method of handling C. O. D. sales in both a retail and wholesale business.

15

L. S. Lyon ships to Harvey T. Lane, to be sold on his account, two hundred articles of X commodity. Lyon pays $40.00 for drayage and $20.00 for insurance on the merchandise. Lane pays freight and drayage, $112.00, and charges $41.50 for storage charges. He sells the goods for $920.00, charges five per cent. commission and remits the net proceeds by New York draft. Explain the entries which should be made on the books of both Lyon and Lane.

LABORATORY MATERIAL

Practice Set No. 3—Continued

February 16

Gave the Sloan Transfer Co. a check for $77.05, in payment of the following: freight inward paid, $30.60; cartage inward, $5.20; cartage outward, $41.25.

Received checks as follows: Gregg Hardware Co., for merchandise sold them February 5th, less discount; Lang Brothers Hardware Co., for merchandise sold them February 6th, less discount.

Employed driver for truck at $20.00 per week, beginning today. His salary will be charged to Delivery Expenses. Add his name to the pay roll list.

In future the company will do its own drayage instead of employing the Sloan Transfer Co. This will necessitate that the company pay its freight bills instead of having them paid by the transfer company as formerly; these bills will be entered and paid twice each month.

E. D. Carpenter reports traveling expenses for the week, $34.75.

Gave J. E. Jones a check for $8.75, in payment for repairs made on office furniture. Debit Administrative Expenses.

Sold Thomas Burke Hardware Company, Danville, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 35, $73.33.

Paid Wickwire Brothers for merchandise purchased from them February 6th, less credit for merchandise returned and less discount.

February 17

Received check from A. P. Barlow, in payment of merchandise sold him February 7th, less discount.

Gave Humphrey a check for $35.00 to reimburse him for expenses incurred on a selling trip.

Sold N. D. Norris & Sons, Kankakee, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 36, $93.45.

February 18

Sold James W. Shore, Champaign, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 37, $96.22.

February 19

Received check from John Hartman, in payment of merchandise sold him February 9th, less discount.

Gave Long a check for $45.00 to cover the expense of a purchasing trip.

Sold Johnson & Lewis Hardware Company, Gary, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 38, $63.70.

February 20

Received check from the Lewis Hardware Company, in payment of merchandise sold them February 10th, less discount.

Bought of W. D. Allen & Co., Cleveland, O., merchandise as per our purchases invoice No. 15, terms 3%, 30-day trade acceptance, $177.20.

Sold T. W. Richardson, Warren, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 39, $69.83.

February 21

Received check from A. W. White, in payment of merchandise sold him February 10th, less discount.

Gave the McIntyre Supply Co. a check for $23.00, in payment for auto supplies. Debit Delivery Expenses.

Withdrew $240.00 from the bank to pay the following: weekly pay-roll, $135.00; E. D. Carpenter, additional expense money, $50.00; Long, for personal use, $25.00; Humphrey, for personal use, $30.00.

Sold Lang Brothers Hardware Co., Crown Point, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 40, $92.28.

February 23

Accepted a 30-day trade acceptance in favor of W. D. Allen & Co., payable at Merchants' National Bank, in payment of merchandise purchased February 20th, as per terms.

Sold James W. Shore, Champaign, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 41, $116.48.

E. D. Carpenter reports traveling expenses for the week, $33.50.

Johnson & Lewis have returned for credit, merchandise valued at $5.00.

February 24

Received check from W. H. Stevens, in payment of merchandise sold him February 14th, less discount.

Sold A. W. White, Paxton, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 42, $133.22.

Paid J. F. Reinhart Mfg. Co. for merchandise purchased from them February 14th, less discount.

Purchased from Henry Disston & Co., Philadelphia, merchandise per our purchase invoice No. 16, terms 2/10, n/60, $579.75.

February 25

Purchased from Russel Erwin Co., Chicago, merchandise per our purchases invoice No. 17, terms 2/10, n/60, $155.52.

Sold A. P. Barlow, Gilman, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 43, $95.32, and E. W. Burke & Co., Wheaton, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 44, $91.45.

Gave the Merchants' National Bank a check in payment of the trade acceptance accepted January 26th.

February 26

Received check from Thomas Burke Hardware Company, in payment of merchandise sold them February 16th, less discount.

Gave Jones Garage a check for $35.00, in payment for repairs of damages to the motor truck caused in an accident.

Sold N. D. Norris & Sons, Kankakee, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 45, $98.94, and W. H. Miller Hardware Co., Matteson, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 46, $74.90.

February 27

Received check from N. D. Norris & Sons, in payment for merchandise sold them February 17th, less discount.

Received a credit bill from Russel Erwin Co. for $18.00 to adjust claim for shortage in invoice received February 25th.

Sales of merchandise, on account, as follows:

Thomas & Lake Hardware Co., Peotone, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 47, $100.80.

The Hall Hardware Co., Lansing, a newly-organized corporation which gave Mr. Humphrey the major part of its initial order, mer-

chandise as per carbon copy of sales invoice No. 48, $2,256.00.. The terms on this order are as follows: one-fourth, 30-day trade acceptance, less 3%; one-half, 60-day trade acceptance, less 3%; balance, 1%, 90 days.

February 28

Received check from James W. Shore, in payment for merchandise sold him February 18th, less discount.

Received a check for $35.00 from the International Lloyds Co., to cover the damages on our truck, which was insured against accident.

Withdrew $195.00 to pay the following: weekly pay-roll, $135.00; Long and Humphrey, each $30.00 for personal use.

Purchased from J. F. Reinhart Mfg. Co., Liberty Mills, merchandise as per our purchases invoice No. 18, terms 2/10, n/60, $584.40.

Sold Central Hardware Co., 555 Milton St., terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 49, $68.17.

Gave United Railways a check for $46.75, freight in during latter half of month.

Sold T. W. Richardson, Warren, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 50, $75.40.

Make the entry for the monthly salary of the partners.

Instructions: 1. Prove cash (balance $428.61) and rule the cash book.

2. Post all books of original entry.

3. Take a Trial Balance of the general ledger.

4. Make a list of the Customers' and Creditors' accounts as shown by the subsidiary ledgers and compare with the controlling accounts.

(Continued on page 422)

CHAPTER XXX

THE CLASSIFICATION OF ACCOUNTS

The Purpose of Account-Keeping

In a preceding chapter it has been explained that an account is a systematic record of information pertaining to some item which appears on the accounting reports, this information being grouped under an appropriate title or heading. From this statement, in regard to the nature of an account, it would appear that the accounts to be kept in connection with any particular business would depend upon the reporting requirements of that business. In fact, there can be no other basis for the classification of information by means of accounts than that of the analysis needed for the preparation of the reports.

There are many and varied reports which may be made in connection with different businesses and for different purposes in the same business. The two reports, however, which are made most frequently in connection with all businesses are the Balance Sheet and the Statement of Profit and Loss. An analysis of the other reports made in connection with a business will show that, in so far as they are made from the accounts, they consist in the main of a rearrangement and probably a more detailed analysis of the information which appears on the Balance Sheet and the Statement of Profit and Loss. Of course, many statistical reports are made in connection with a business which are not based on the accounts.

It is customary, therefore, in deciding upon the number and nature of the accounts to be kept to have in mind the information necessary to prepare the Balance Sheet and Statement of Profit and Loss. It is assumed that if the accounts provide the information necessary to prepare these two reports, it will be possible to prepare from them the other reports desired. This is not always true, but for the purpose of the present discussion it may be accepted as a fair assumption.

The Fundamental Classification of Accounts

In preceding chapters dealing with the Balance Sheet and the Statement of Profit and Loss, it has been explained that there is certain information which is fundamental in character and which is demanded by the owners of every business, regardless of its size, nature, or organization. This information is of two kinds: first, the financial condition of the business, which is shown by the Balance Sheet; secondly, the results of the operation of the business during a certain period of time, which is shown by the Statement of Profit and Loss. It might seem, therefore, that accounts might be divided into two classes: the first class including those which show financial condition and appear on the Balance Sheet, the second class including those which show results of operation and appear on the Statement of Profit and Loss. This division is employed by some writers who designate the Balance Sheet items as "real" accounts, and the Profit and Loss items as "nominal," "economic," or "revenue" accounts. Professor Wildman, for instance, in his very excellent text, "Principles of Accounting," classifies accounts as follows: (1) real accounts which reflect financial condition; and (2) nominal accounts, which reflect changes in financial condition.

Such a classification is defensible, since it brings out the distinction between the two classes of accounts which are essentially different. The criticism which may be offered against this classification is: there are certain accounts which do not clearly fall into either of these groups. Although on the basis of their use in the reports, accounts fall naturally into Balance Sheet accounts and Profit and Loss accounts, there are shown on the Balance Sheet items taken from two classes of accounts, both clearly distinct and both co-ordinate in importance with one another and with the Profit and Loss or Revenue accounts. The first class shows the property owned by the business and the claims against that property; therefore may appropriately be termed *property* accounts. The second class shows the interest of the proprietor in the business; so may appropriately be termed *proprietorship* accounts. It is suggested, therefore, that all accounts may be classified under the following headings:

1. Property Accounts.
2. Proprietorship Accounts.
3. Revenue Accounts.

This classification needs little explanation and is in accord with the discussion in the preceding chapters on the use of accounts.

Property accounts include all asset and liability accounts showing the kinds and amount of property used in the business, and the claims against that property. Proprietorship accounts take in all the accounts which may be employed to show the amount of proprietorship; that is, the difference between the total assets and the total liabilities. Revenue accounts are the accounts which show the amount and sources of the income of the business for a given period, and the amount and kinds of expenses incurred in securing it. The first two classes appear on the Balance Sheet and the third class on the Statement of Profit and Loss.

The Property Accounts

As stated in the preceding paragraph, the property accounts are the accounts with the various assets or property employed in the business and the accounts with the liabilities or claims against the assets. The property accounts, therefore, may be said to fall into two main groups: *asset* accounts and *liability* accounts.

By referring to the Balance Sheet given in Illustration No. 29, it will be seen that the asset accounts may be classified as follows:

1. Current Assets.
2. Deferred Charges to Expense.
3. Fixed Assets.

The meaning of each of the above classes has been explained and illustrated previously so need not be discussed at this time.

The liability accounts may be classified as follows:

1. Current Liabilities.
2. Fixed Liabilities.

Current liabilities have been discussed in previous chapters and fixed liabilities will be explained and illustrated in subsequent chapters. In order, however, that the present classification of accounts may be more complete it may be explained that fixed liabilities are those which are to be outstanding for a relatively long period of time. Such liabilities are usually incurred with the understanding that they are to be repaid at a definite time, but at a time well in the future. They are not paid as a normal procedure by the liquidation of assets as are current liabilities, but will have some special arrangement made for their retirement. Mortgages payable and bonds payable are illustrations of fixed liabilities. A more detailed discussion of their nature and treatment in the accounts will be given in subsequent chapters.

Illustration of the Property Accounts

On the basis of the foregoing discussion the property accounts may be outlined as follows:

I. Property Accounts
  A. Asset Accounts
    1. Current Assets
      (a) Cash
      (b) Notes Receivable
      (c) Accounts Receivable
      (d) Reserve for Bad Debts
      (e) Merchandise Inventory
      (f) Accrued Interest
    2. Deferred Charges
      (a) Prepaid Advertising
      (b) Unexpired Insurance
    3. Fixed Assets
      (a) Furniture and Fixtures
      (b) Reserve for Depreciation of Furniture and Fixtures
      (c) Buildings
      (d) Reserve for Depreciation of Buildings
      (e) Land
  B. Liability Accounts
    1. Current Liabilities
      (a) Notes Payable
      (b) Accounts Payable
      (c) Accrued Wages
    2. Fixed Liabilities
      (a) Mortgages Payable
      (b) Bonds Payable

No attempt is made in the foregoing outline of the property accounts or in the remaining outlines given in this chapter to give an exhaustive list of accounts. Only a few of the more customary accounts under each class are given.

The Proprietorship Accounts

The difference between the assets and liabilities as shown in the property accounts gives the proprietorship of the business. The amount of the proprietorship is shown by the proprietorship accounts. The number of these accounts and the nature of the items

which they represent will vary with the organization and business policies of the business. To a considerable extent the number and nature of the proprietorship accounts depend on whether the business is organized as a single proprietorship, a partnership, or a corporation.

In the case of a single proprietor, there will be two accounts usually which must be considered in determining the proprietorship —the proprietor's Capital account and his Personal account. At the end of the period the Personal account is closed usually into the Capital account.

In a partnership, there is a Capital account and a Personal account for each partner. In some cases a part of the profits of the partnership is not distributed to the partners, but is carried, at least temporarily, in an Undivided Profits account. If A. L. Anderson and A. M. Chapman are partners in the firm of Anderson & Chapman, their proprietorship accounts may be as follows:

II. Proprietorship Accounts
- (a) A. L. Anderson, Capital
- (b) A. L. Anderson, Personal
- (c) A. M. Chapman, Capital
- (d) A. M. Chapman, Personal
- (e) Undivided Profits

The proprietorship accounts of a corporation will be explained and illustrated in a subsequent chapter.

The Revenue Accounts

The third main group into which the accounts of a business may be divided is that of the *revenue* accounts. The revenue accounts are the accounts with those items which represent the sources and amount of the income of the business for a given period, and the kinds and amount of the expenses incurred in the process of securing that income. It will be seen at once that there are two main divisions of revenue accounts, namely, *income* accounts and *expense* accounts.

By reference to the Statement of Profit and Loss given in Illustration No. 30, it will be seen that the income accounts may be classified as follows:

1. Operating Income Accounts.
2. Non-operating Income Accounts, or "Other" Income Accounts.

By reference to the same illustration it will be seen that the expense accounts may be classified as follows:

1. Operating Expense Accounts.
2. Non-operating Expense Accounts, or "Deductions from Income" Accounts.

The operating expenses accounts may be classified further as:

1. Cost of Sales Accounts.
2. Buying Expense Accounts.
3. Selling Expense Accounts.
4. Delivery Expense Accounts.
5. Administrative Expense Accounts.

The cost of sales accounts are usually not shown on the Statement of Profit and Loss as operating expenses, but they are in their essence an expense, since they represent part of the cost of the product or service sold. For convenience, therefore, they are classified as an expense in the classification outlined in this chapter.

The meaning of each of the foregoing classes has been explained and illustrated previously, so need not be discussed here.

Illustration of the Revenue Accounts

On the basis of the above discussion the revenue accounts may be outlined as follows:

III. Revenue Accounts
- A. Income Accounts
  - 1. Operating Income
    - (a) Merchandise Sales (With Sales Returns and Allowances)
  - 2. Non-operating Income
    - (a) Rentals Earned
    - (b) Interest on Notes Receivable
    - (c) Purchases Discount
- B. Expense Accounts
  - 1. Operating Expenses
    - (a) Cost of Sales
      - (1) Purchases (With Adjustments for Inventories and Purchases Returns and Allowances)
    - (b) Buying Expenses
      - (1) Salaries of Buyers
      - (2) Traveling Expense of Buyers
      - (3) Office Expense
      - (4) Miscellaneous Buying Expense

III. Revenue Accounts—*Continued*
  B. Expense Accounts—*Continued*
    (c) Selling Expense
      (1) Salaries of Sales Force
      (2) Expenses of Salesmen
      (3) Office Expense
      (4) Packing and Shipping
      (5) Advertising
      (6) Miscellaneous Selling Expense
    (d) Delivery Expense
      (1) Wages of Delivery Drivers
      (2) Maintenance of Delivery Equipment
      (3) Depreciation of Delivery Equipment
      (4) Miscellaneous Delivery Expense
    (e) Administrative Expense
      (1) Office Salaries
      (2) Office Expense
      (3) Repairs and Maintenance of Building and Equipment
      (4) Depreciation on Buildings and Equipment
      (5) Insurance
      (6) Taxes
      (7) Heat and Light
      (8) Miscellaneous Administrative Expense
  2. Non-operating Expenses
    (a) Interest on Notes Payable
    (b) Sales Discount

No attempt has been made to make the foregoing list of revenue accounts exhaustive. Those given are indicative of the accounts which may be included in each class.

Numbering of Accounts

In a business of material size the accounts required to make a proper analysis of its operations may be numerous. As a consequence the account title may not indicate the classification and subclassification of each account very readily. In order to facilitate the classification as well as the reference to accounts the *numbering* of accounts is employed. Each account is given a number which usually is written just before the account title. This number can be used to identify the classification of the account and it may be

used also as a means of referring to the account, since it is briefer than the account title.

For instance, it has been explained above that the three main classes of accounts are: property, proprietorship, and revenue accounts, and these accounts may be numbered as follows:

1. Property Accounts.
2. Proprietorship Accounts.
3. Revenue Accounts.

All property accounts will be given a number the first digit of which will be "1," all proprietorship accounts a number the first digit of which will be "2," and all revenue accounts a number the first digit of which will be "3." To illustrate, the property accounts are divided into two main groups and these may be numbered as follows:

11. Assets Accounts
12. Liability Accounts.

Each asset account will be given a number the first two digits of which will be "11," and a similar procedure will be followed with the liabilities.

Illustration of the Numbering of Accounts

In order to illustrate more fully the method of numbering accounts the following outline of accounts with their appropriate numbers is given:

1. Property Accounts
    11. Asset Accounts
        111. Current Assets
            1111. Cash
            1112. Notes Receivable
            1113. Accounts Receivable
            11103. Reserve for Bad Debts (zero preceding last digit indicates its opposite tendency)
            1114. Merchandise Inventory
            1115. Accrued Interest
        112. Deferred Charges to Expense
            1121. Prepaid Advertising
            1122. Unexpired Insurance

1. Property Accounts—*Continued*
    11. Asset Accounts—*Continued*
        113. Fixed Assets
            1131. Furniture and Fixtures
            11301. Reserve for Depreciation of Furniture and Fixtures
            1132. Building
            11302. Reserve for Depreciation of Buildings
            1133. Land
    12. Liability Accounts
        121. Current Liabilities
            1211. Notes Payable
            1212. Accounts Payable
            1213. Accrued Wages
        122. Fixed Liabilities
            1221. Mortgages Payable
            1222. Bonds Payable
2. Proprietorship Accounts
    21. Proprietor, Capital Account
    22. Proprietor, Personal Account
3. Revenue Accounts
    31. Income Accounts
        311. Operating Income
            3111. Merchandise Sales
        312. Non-operating Income
            3121. Rentals Earned
            3122. Interest on Notes Receivable
            3123. Purchases Discount
    32. Expense Accounts
        321. Operating Expense
            3211. Cost of Sales
                32111. Purchases
            3212. Buying Expense
                32121. Salaries of Buyers
                32122. Traveling Expense of Buyers
                32123. Office Expense
                32124. Miscellaneous Buying Expense
            3213. Selling Expense
                32131. Salaries of Sales Force
                32132. Expenses of Salesmen
                32133. Office Expense
                32134. Packing and Shipping
                32135. Advertising
                32136. Miscellaneous Selling Expense

3. Revenue Accounts—*Continued*
   - 321. Operating Expense—*Continued*
     - 3214. Delivery Expense
       - 32141. Wages of Delivery Drivers
       - 32142. Maintenance of Delivery Equipment
       - 32143. Depreciation of Delivery Equipment
       - 32144. Miscellaneous Delivery Expense
     - 3215. Administrative Expense
       - 32151. Office Salaries
       - 32152. Office Expense
       - 32153. Repairs and Maintenance of Building and Equipment
       - 32154. Depreciation on Buildings and Equipment
       - 32155. Insurance
       - 32156. Taxes
       - 32157. Heat and Light
       - 32158. Miscellaneous Administrative Expense
   - 322. Non-operating Expense
     - 3221. Interest on Notes Payable
     - 3222. Sales Discount

Different Methods of Numbering Accounts

There are several different methods of numbering accounts which are in current use. The foregoing method is simple and is practical if the different accounts under each class are not too numerous. In a business where a very detailed analysis of income and expenses is necessary this method would become rather awkward. For such cases more elaborate methods are employed. It is not thought wise, however, to introduce a discussion of these methods at this time. For such a discussion the student can consult various texts on accounting which discuss this subject more in detail.

Different Methods of Classifying Accounts

There are several different methods of classifying accounts. The chief difference between these methods is one of terminology rather than one of purpose or result. Classifications differing somewhat in terminology from the foregoing can be found in "Principles of Accounting," by John R. Wildman, "Accounting Principles," by Thomas W. Mitchell, and "Accounting Theory and Practice," Vol. I, by Roy B. Kester.

QUESTIONS FOR CLASS DISCUSSION

1

We are requested by the Torr Mercantile Company to draw up a classification of accounts for their business. Explain what information you would desire before you attempt to construct this classification.

2

Explain and illustrate the meaning of property accounts, proprietorship accounts, and revenue accounts.

3

Name the principal property accounts which would be maintained by a retail clothing store.

4

Give the proprietorship accounts which would be maintained by a partnership having three members.

5

The Torr Mercantile Company buy and sell on account. They receive a discount on purchases, but give no discount on sales. They maintain a delivery service and own the building in which they conduct their business. Explain the principal revenue accounts which would be maintained by this company.

6

Explain and illustrate the meaning of current assets, deferred charges to expense, fixed assets, current liabilities, and fixed liabilities.

7

Explain and illustrate the meaning between operating income and non-operating income.

8

Explain and illustrate the meaning between operating expenses and non-operating expenses.

9

The Merchants' National Bank receives during its fiscal year $10,000.00 as interest on notes receivable. The Brown Mercantile Company receive $20.00 as interest on notes receivable due from customers. Explain with reasons how these two items would be classified on a Statement of Profit and Loss of the two companies.

10

Explain the purpose of numbering accounts. Explain and illustrate one method of numbering accounts.

LABORATORY MATERIAL

Practice Set No. 3—Continued

Instructions: 1. The following adjustments are to be made:

(1) Reserve for Bad Debts 1% of Accounts Receivable.

(2) Depreciation on Fixed Assets:
- (a) Furniture and Fixtures, 2%.
- (b) Stockroom Equipment, 2%.
- (c) Delivery Equipment, 1%.

(3) Accruals as follows:
- (a) E. D. Carpenter, traveling expenses for the week, \$35.00. This estimate is based on previous expenses.
- (b) Light for February, \$20.00; telephone service and telegrams, \$20.00; water, \$2.50.

(4) Inventories are as follows:
- (a) Merchandise, \$13,930.69.
- (b) Shipping Supplies, \$40.00.
- (c) Office Supplies, \$60.00.
- (d) Unexpired Insurance on delivery truck, \$23.00.
- (e) Unexpired Insurance on merchandise, \$125.00.

(5) Receiving and Shipping Expense is to be apportioned equally between Freight and Cartage In and Freight and Cartage Out.

(6) Delivery Expense is to be apportioned equally between Freight and Cartage In and Freight and Cartage Out.

2. Prepare a Working Sheet, Balance Sheet and a Statement of Profit and Loss. Show Freight and Cartage Outward as a selling expense on the Statement of Profit and Loss. These statements are to be used in connection with the laboratory material at the close of Chapter XXXIV.

3. Make the journal entries necessary to give effect to the adjustments stated above and post the same.

4. Make the journal entries necessary to close the ledger accounts and post the same.

5. Make the post-closing entries.

6. Make a post-closing Trial Balance.

(Continued on page 436)

CHAPTER XXXI

DEPARTMENTAL REVENUE ACCOUNTS

Need for Departmental Revenue Accounts

In previous chapters it has been explained that it is desirable to make some analysis of the transactions which involve the purchase or sale of the commodity or service in which a business deals. In the first place it was stated in Chapter IV that purchases, sales, and inventory should be recorded in separate accounts; and later, in Chapter XXI, it was explained that a further analysis is desirable in order to show freight and cartage in, freight and cartage out, purchases returns and allowances, and sales returns and allowances as separate items. In order to afford the analysis called for by the discussions in Chapter IV and Chapter XXI, it is necessary to maintain accounts with the following items: (1) inventory, (2) purchases, (3) freight and cartage in, (4) purchases returns and allowances, (5) sales, (6) sales returns and allowances, and (7) freight and cartage outward.

The discussion in the previous chapters, however, assumes that in a given business enterprise either there is only one class of merchandise to be considered, or if there is more than one class it is not desirable to make an analysis of the transactions with the different classes. In a small business this assumption is true, for the owner is concerned primarily in the total net profit obtained as a result of the transactions in connection with all classes of merchandise and finds it inexpedient to attempt to obtain the profit made on separate items or separate classes of goods. In larger businesses, however, it is usually found desirable, both for administrative and accounting reasons, to divide the commodities bought and sold into two or more groups. To illustrate this in a simple way, it may be assumed that a certain business concern sells both hardware and furniture. In this case there are several considerations which would make it desirable for the management to keep separate the data concerning

the two classes of commodities. Some of these considerations may be indicated as follows:

1. The two commodities in all probability yield different rates of profit and it is desirable to know the profit yielded by each. It is even possible that it may be found that one of these commodities yields no profit and that the profit shown on the accounting reports all arises from the other commodity. As a consequence something must be done to remedy the situation and as a last resort the handling of the commodity yielding no profit may be discontinued.

2. In a business of sufficient size to require a separate manager of each department, it will be desirable to know the profits of each department in order to be able to judge the efficiency of each.

3. The amount of funds required to finance the same amount of sales for each commodity will probably be different. Consequently, in making future plans in regard to the amount of funds it will take to finance the business, it will be necessary to know the volume of business of each department.

The student, no doubt, can think of many businesses that handle two or more groups of commodities and can think of reasons why the management of each business should have separate information with reference to the results of trading in each group of commodities. The foregoing illustration, however, will be sufficient for the present discussion.

Departmental Analysis in the Accounts

When a business is dealing in two or more classes or types of commodities, such as those suggested above, the management usually considers it desirable to divide the business into *departments*, each of which has to do with a certain group of commodities. Thus, in the business already mentioned, the records of the trading operations might be kept on the basis of a hardware department and a furniture department. If the business were large enough to make it practicable, the entire business might be organized along departmental lines, each department having its own manager and its own sales force, and being charged with its share of all operating expense, ascertained on whatever basis seemed desirable under the

circumstances. Such a complete departmental organization as this, however, is not practicable for a smaller business.

In any case, though, it is possible to have the records furnish information on merchandise sales, purchases, inventory, purchase returns and allowances, freight and cartage, both inward and outward, sales returns and allowances, and gross profit on sales, all on a departmental basis. This will, of course, necessitate the carrying in the ledger of an account with each of these items, for each department of the business. Thus, in the case cited above, the trading group of accounts would include hardware purchases, furniture purchases, hardware purchases returns and allowances, furniture purchases returns and allowances, hardware sales, furniture sales, and so on through the entire list of accounts kept with trading operations, as listed in the first paragraph of the present chapter.

Departmental Analysis in the Books of Original Entry

If the ledger accounts are to show such a departmental analysis of trading operations as that indicated in the preceding paragraph, it is necessary that the books of original entry should be designed to provide for this analysis in making the entries for each transaction which directly affects the trading group of accounts. This provision can best be made by the introduction of additional columns into the books of original entry. Thus, using the same business illustration, which was assumed to divide its trading accounts between the hardware and furniture departments, it will be seen that several of the books of original entry need to be modified to adapt them to this end. In order to make this perfectly clear, we must consider each account separately in what is here called the trading group, with the modifications which are necessary in the books of original entry by the division of each account on a departmental basis. In the illustrations which appear in this connection, no attempt has been made to represent anything like the number or volume of transactions which would take place in any accounting period. Only a sufficient number of transactions have been given to illustrate the types of transactions under consideration, to show how such transactions may be entered in the books of original entry, and the procedure to be followed in posting them to the accounts.

Merchandise Purchases

Assume for purpose of illustration that the following represent the purchases of merchandise made by the concern under consid-

eration for an entire accounting period, all dates being omitted, since it is not intended to represent anything approaching the number of transactions that would actually take place in such a business:

PURCHASES:

Simmons Hardware Company, St. Louis, Mo., hardware, $500.00, terms 1/10/n/60.

Crowell Furniture Company, Grand Rapids, Mich., furniture, $600.00, terms 2/10/n/60.

Boutell Furniture Company, St. Paul, Minn., furniture, $750.00, terms 2/10/n/60.

W. D. Allen Company, Chicago, hardware, $450.00, terms 1/10/n/30.

A form of purchases journal which would provide for the analysis of the purchases by departments would appear, after these representative transactions have been entered and the journal totalled, ruled and posted, as follows:

February, 192..

Date	Account Credited	Address	Terms	Inv. No.	L.F.	Accts. Pay. Cr.	Hdwe. Pur. Dr.	Furn. Pur. Dr.
1	Simmons Hdwe Co.	St. Louis	1/10, n/60	27	12	500.00	500.00	
6	Crowell Furn. Co.	St. Paul	2/10, n/60	28	17	600.00		600.00
10	Boutell Furn. Co.	Chicago	2/10, n/60	29	8	750.00		750.00
20	W. D. Allen Co.	St. Louis	1/10, n/30	30	6	450.00	450.00	
						2,300.00	950.00	1,350.00
						(9)	(13)	(14)

It will be noted that the form of purchases journal illustrated furnishes the same information concerning each invoice that is furnished by forms shown previously. It also provides for an analysis of the merchandise purchases of the two departments. The credit for all the purchase transactions is posted to Accounts Payable as a single item obtained by totalling the "Accounts Payable, Cr." column, while the purchase debits are divided and posted to the debit of the two departmental purchases accounts through the footings of the two columns, "Hardware Purchases, Dr." and "Furniture Purchases, Dr." The posting to the individual accounts in

Note—The results of the posting from the different books of original entry, in so far as it affects the trading group of accounts, will be shown after all the books from which postings are made to these accounts have been illustrated.

the creditors' ledger is exactly the same as it would be if no departmental analysis were provided.

Purchases Returns and Allowances

Purchase returns and allowances require exactly the same analysis as purchases, except that, since they represent a deduction from the cost of goods sold and a debit to the creditor (accounts payable), the debits and credits will be exactly reversed. For purposes of continuing the illustration of departmental analysis in the books of original entry, it will be assumed that the purchase returns and allowance transactions for the period under consideration are as follows:

Returned to Simmons Hardware Company, hardware, the invoiced price of which was $250.00.

Returned to the Boutell Furniture Company, furniture, the invoiced price of which was $200.00.

A form of purchases returns and allowances journal which provides for the departmental analysis is shown below, with these two representative transactions entered and posted.

February, 192..

Date	Account Debited	Address	Inv. No.	L.F.	Accts. Pay. Dr.	Hdwe. Ret. & Allow. Cr.	Furn. Ret. & Allow. Cr.
10	Simmons Hdwe. Co.	St. Louis	27	12	250.00	250.00	200.00
21	Boutell Furn. Co.	Chicago	29	8	200.00		
					450.00	250.00	200.00
					(9)	(13)	(14)

The posting from this form of journal should not require any explanation, since the procedure is evidently the same as that followed in posting from the purchases journal with the debits and credits reversed. Accounts Payable will be debited and the two departmental purchases returns and allowances accounts will be credited through the footings of the three columns used. Each item will be posted to the debit of an individual account in the creditors' ledger, this posting being done either directly from the journal or from the returned goods invoice. If the purchases returns and allowances are not numerous they may be recorded in the general journal instead of being recorded in the separate journal explained and illustrated. The latter method will be employed for simplicity in the accompanying practice set.

Sales

If it is assumed that the business under consideration is a wholesale business in which practically all sales are made on account, the form of sales journal may be similar to that of the purchases journal. All sales made will be recorded in the "Accounts Receivable" column and the total of this column will be posted to the debit of accounts receivable. The hardware sales and furniture sales will be recorded in separate columns and the total of these columns will be posted to the credit of hardware sales and furniture sales.

To illustrate this, assume that the following sales have been made:

King Hardware Co., St. Louis, furniture . .	$595.00
Babson Mercantile Co., Detroit, hardware .	360.00
Paul Furniture Co., Kansas City, furniture .	360.00
Wilson & Co., Cleveland, hardware	330.00
James & Weber, Buffalo, furniture	550.00
Peters & Co., Wichita, hardware	300.00

When recorded in the sales journal these transactions will appear as follows:

February, 192..

Date	Account Debited	Address	Terms	L.F.	Sale No.	Accts. Rec. Dr	Hdwe. Sales Cr.	Furn. Sales Cr.
4	King Hdwe. Co.	St. Louis	1/10, n/60	16	24	595.00		595.00
10	Babson Mer. Co.	Detroit	1/10, n/60	10	25	360.00	360.00	
15	Paul Furn. Co.	Kansas City	2/10, n/60	12	26	360.00		360.00
19	Wilson & Co.	Cleveland	30 days	19	27	330.00	330.00	
21	James & Weber	Buffalo	2/10, n/30	8	28	550.00		550.00
26	Peters & Co.	Wichita	1/10, n/60	5	29	300.00	300.00	
						2,495.00	990.00	1,505.00
						(3)	(21)	(22)

Sales Returns and Allowances

Continuing the foregoing illustration, assume that the sales returns and allowances for the period in question are as follows:

King Hardware Company, return for credit furniture purchased on account, $45.00.

Wilson & Co., return for credit hardware purchased on account, $15.00.

Peters & Co., are allowed $25.00 on account of defective hardware sold them.

These returns and allowances may be recorded in the general journal, or if they are numerous may be recorded in a separate journal. If recorded in the latter they will appear as follows:

February, 192..

Date	Account Credited	Address	L.F.	Sale No.	Accts. Rec. Cr.	Hdwe. Sales Ret. & Allow. Dr.	Furn. Sales Ret. & Allow. Dr.
6	King Hdwe. Co.	St. Louis	16	24	45.00		45.00
20	Wilson & Co.	Cleveland	19	27	15.00	15.00	
27	Peters & Co.	Wichita	5	29	25.00	25.00	
					85.00	40.00	45.00
					(3)	(21)	(22)

The posting of this record is apparent from the columnar headings.

In a retail business there are frequent cash sales and these are usually entered as daily totals. In a business where a departmental analysis of sales is not made the cash sales may be posted from the cash record and not be entered in the sales record. If, however, a departmental analysis is desired it is rather inconvenient to show this on the cash record so the cash sales are entered as a total in the cash record and then are recorded in the sales record so as to show the sales of each department. If the regular form of sales record is used this would necessitate the introduction of an additional column in the sales record which would show the total cash sales. In this case the total of the "Accounts Receivable" column and of the "Cash Sales" column will equal the total of the "Departmental Sales" column. The "Cash Sales" column will not be posted, since the receipts from cash sales will be included in the Cash total in the cash record and be posted to the debit of Cash accordingly.

Various methods of handling sales and of making the original record thereof are employed in practice. No attempt is made to explain these various methods here, since the primary purpose of the present discussion is to show the value of departmental analysis and to indicate its effect on the accounts and reports.

Freight, Express and Cartage

Freight, express and cartage inward is a part of the "laid down" cost of the merchandise sold, and must therefore be added to the purchases in order to arrive at the full cost of goods sold.

Freight, express and cartage outward represents the cost of delivering sold goods to the railroad station and of the transportation of the goods to the purchaser when the seller agrees to pay the transportation costs. The drayage cost is almost invariably borne by the seller, but the transportation cost is paid usually by the purchaser. Accountants differ as to how the cost of freight, express and cartage outward should be shown on the Statement of Profit and Loss. Some argue that it should be subtracted from gross sales in the same manner in which freight and cartage in is added to purchases. In other words, the former decreases the returns from sales in the same manner that freight in increases the cost of purchases. Others contend that freight, express and cartage out is a selling expense and should be treated accordingly as explained on page 309. Supporting this argument, it is pointed out that in a retail business delivery expenses are always treated as an operating expense and frequently as a part of selling expense. In *this* discussion freight, express and cartage outward will for simplicity be treated as a deduction from gross sales.

For purposes of managerial information, it is desirable to have both freight and cartage in and freight and cartage out carried in separate accounts rather than to charge them directly into the Sales or the Purchases account. Since this is true, it follows that in order to obtain the correct figure of gross trading profit for each department of the business, it will be necessary to have each of these two accounts divided on a departmental basis, like the rest of the trading accounts. There are two methods by which this is done, both of which will be briefly indicated. For purposes of the illustration of the books of original entry the second method will be assumed to be the one in use in the business with which that illustration deals.

First Method

In many cases the organization of the business or the method of handling shipments, either inward or outward, is such that it is not feasible to keep all charges for freight and cartage separated at the time of their entry as charges on inward shipments and those on outward shipments. And sometimes in cases where it is possible to make such a separation it is not practicable to separate these items at the time of their entry among the departments involved. When either or both of these things is true, the items must be apportioned and divided at the end of the accounting

period on the basis of some sort of an estimate. Suppose then, for example, a business has two departments, called A and B. During a given period all charges to freight, express and cartage have been debited to a single account with freight, express and cartage. At the end of the period this account shows a debit balance of $1,260.00. It is estimated by those in charge of the departments that two-thirds of this amount was incurred on shipments inward and one-third on shipments outward. Of the amount apportioned to expense on inward shipments, three-fifths is estimated to be chargeable to Department A and two-fifths to Department B. On outbound shipments the expenses of the two departments are estimated to be equal.

The journal entries necessary to put into effect the apportionment of the accounts involved would be as follows:

June 30		
Freight, Express, and Cartage Inward	$840.00	
Freight, Express, and Cartage Outward	420.00	
Freight, Express, and Cartage		$1,260.00
30		
Freight, Express, and Cartage Inward, Dept. A	336.00	
Freight, Express, and Cartage Inward, Dept. B	504.00	
Freight, Express, and Cartage Inward		840.00
30		
Freight, Express, and Cartage Outward, Dept. A	210.00	
Freight, Express, and Cartage Outward, Dept. B	210.00	
Freight, Express, and Cartage Outward		420.00

After these entries have been posted, the ledger accounts affected would appear as follows:

Freight, Express, and Cartage

June	30	Balance		1,260 00	June	30	To close		1,260 00

Freight, Express, and Cartage Inward

June	30			840 00	June	30			840 00

Freight, Express, and Cartage Outward

June	30			420 00	June	30			420 00

Freight, Express, and Cartage Inward—Dept. A

June	30			336 00					

Freight, Express, and Cartage Inward—Dept. B

June	30			504 00					

Freight, Express, and Cartage Outward—Dept. A

June	30			210 00					

Freight, Express, and Cartage Outward—Dept. B

June	30			210 00					

Second Method

If feasible, it is desirable that the charges of this type be distributed to the accounts to which they belong at the time the charges are paid and entered. If this method is followed, the distribution will ordinarily be made through the cash disbursements journal. It would, of course, be possible to have a column in that book for each of the accounts affected, but usually it would not be considered expedient to provide four or more columns in the cash disbursements journal for recording items which occur with such relative infrequency as these do. Ordinarily, therefore, the debits would be entered in the "General" column, and posted from there.

It will be assumed that the business with whose trading operations the foregoing discussion deals has two departments, hardware and furniture, and that the following charges are to be made to freight, express and cartage:

Freight and Cartage on Simmons Hardware Co.'s shipment to us, $17.50.

Freight on Crowell Furniture Co.'s shipment to us, $22.50.

Freight on Boutell Furniture Co.'s shipment to us, $24.00.

Freight on our shipment to Thos. Wilson, $18.00. This is to be charged as follows: to hardware, $6.00; to furniture, $12.00.

The cash disbursements journal for this business, containing the payments for freight and cartage given above and a few additional entries, might appear as follows:

JUNE **Cash Disbursements**

Date	Account Debited	Explanation	Accts. Pay. Fol.	Gen. Fol.	Sundry Accts Dr.	Accts. Pay. Dr.	Pur. Disct. Cr.	Cash Cr.
1	Rent	For period		31	100.00			100.00
3	Frt. & Cartage In—Hdwe.	Inv. #27		15	17.50			17.50
5	Grand Rapids Chair Co.	Inv. #26	7			600.00	12.00	588.00
6	Sales Ret. & All—Hdwe.	Cash		21	15.00			15.00
10	Freight In—Furn.	Inv. #28		16	22.50			22.50
13	Simmons Hdwe. Co.	Inv. #27	12			500.00	5.00	495.00
15	Advertising	For period		34	75.00			75.00
18	Freight In—Furn.	Inv. #29		16	24.00			24.00
20	Freight Out—Hdwe.	Thos. Wilson		23	6.00			6.00
25	Freight Out—Furn.	Thos. Wilson		24	12.00			12.00
29	Salaries	For period		32	200.00			200.00
30	Balance							2,130.00
					472.00	1,100.00 (9)	17.00 (42)	3,685.00

In the form of cash disbursements journal here illustrated, there is very little provision for distributing the debits to various accounts by means of special columns; therefore, most of the debits must be posted separately from the "Sundry Accounts, Dr." column. The procedure to be followed in posting this journal does not require any explanation at this point.

QUESTIONS FOR CLASS DISCUSSION

1

The J. B. Reynolds Furniture Company sell furniture, both wholesale and retail. They desire to know the gross profits made from the retail business and the wholesale business. Explain a method by which this company will be able to obtain this information.

2

Give the trading accounts which the company will have to maintain in order to provide the information called for by Question 1.

3

What effect will the use of these additional accounts have on the books of original entry of this company?

4

Describe the record which will be necessary to record its purchases.

5

Describe the record which will be necessary to record its sales.

6

Explain how it may record its purchases returns and its sales returns.

7

The Brown Clothing Company sell men's and ladies' ready-to-wear at wholesale. The Smith Clothing Company sell the same goods at retail. Each company desires a departmental analysis of its sales. In what way may the sales records of the two companies differ?

8

The James Wholesale Company have two departments, A and B. It is found impracticable to keep separate the expenditures for freight and drayage on merchandise purchased and merchandise sold, or to keep separate the freight and drayage for the two departments. Consequently all freight and drayage are debited to one account. At the end of the fiscal period this account shows a debit balance of $1,500.00. It is estimated that one-fifth of this

represents freight and drayage out and that the remainder represents freight and drayage in. It is further estimated that each department has benefited equally by these expenditures. Give the entries necessary to allocate the freight and drayage to the proper accounts.

9

If the James Company find that it is possible to keep the charges for freight and drayage of the two departments, both inward and outward, separated, what method may be employed in recording them?

10

The King Dry Goods Store sells shoes, millinery, men's ready-to-wear and ladies' ready-to-wear. It keeps but one set of trading accounts. Give the advantages which it may obtain from a departmental analysis of its trading operations.

LABORATORY MATERIAL

Practice Set No. 3—Continued

MARCH

PRELIMINARY INSTRUCTIONS

Division of Trading Accounts

The firm has decided to divide their business into two departments: general hardware, and cutlery. Accordingly, separate accounts will be maintained with the various merchandise items. The following accounts will be opened on the pages indicated:

10 Hardware Sales
10 Cutlery Sales
11 Hardware Sales Returns and Allowances
11 Cutlery Sales Returns and Allowances
12 Hardware Freight, Express and Cartage Outward
12 Cutlery Freight, Express and Cartage Outward
13 Hardware Purchases
13 Cutlery Purchases
14 Hardware Purchases Returns and Allowances
14 Cutlery Purchases Returns and Allowances
15 Hardware Freight, Express and Cartage Inward
15 Cutlery Freight, Express and Cartage Inward

Merchandise Inventory

The merchandise inventory as shown by the Merchandise Inventory account is $13,930.69. This consists of general hardware $11,404.16 and cutlery $2,526.53. Henceforth, it will be necessary to record separately the inventory for the two departments. This can be done by recording both inventories in the same account but as separate items with the proper explanation in the explanation column. In order to show this division of the inventory on March 2nd, the following journal entry should be made:

Hardware Inventory	$11,404.16	
Cutlery Inventory	2,526.53	
Merchandise Inventory		$13,930.69

When this entry is posted the Merchandise Inventory account will appear as shown at the top of page 437.

Merchandise Inventory

Feb.	28		J. 1	13,930	69	Mar.	2		J. 2	13,930	69
Mar.	2	Hardware	J. 2	11,404	16						
		Cutlery	J. 2	2,526	53						

Division of Expense Accounts

During March the selling expenses will be recorded in the following accounts which will be opened on the pages indicated:

16 Miscellaneous Selling Expenses
18 Salaries of Salesmen
18 Traveling Expenses of Salesmen
18 Advertising

Administrative expenses will be recorded in the following accounts which will be opened on the pages indicated:

20 Rent
21 Telephone and Telegraph
21 Office Salaries
21 Miscellaneous Administrative Expenses

It will be necessary to adjust the credits to the expenses accounts in the same manner as the Inventory account. This adjustment requires the following entries:

Selling Expenses	\$35.00	
Traveling Expenses of Salesman . .		\$35.00
Administrative Expenses	42.50	
Telephone and Telegraph		20.00
Miscellaneous Admr. Expenses . .		22.50

Transactions for March

March 2

Received check from T. W. Richardson, in payment for merchandise sold him February 20th, less discount.

Gave the People's Title & Trust Company a check for \$150.00, in payment for the March rent.

Sold Thomas & Lake Hardware Co., Peotone, terms 2/10, n/60, hardware as per carbon copy of sales invoice No. 51, \$126.55.

Received two trade acceptances from the Hall Hardware Co., as per terms of the sale made to them February 27th. These trade acceptances were accepted February 28th, payable at Second National Bank of Lansing.

Mr. Carpenter reports traveling expenses for the week, $36.75.

Received check from Lang Brothers Hardware Co., in payment of merchandise sold them February 21st, less discount.

Paid February bills as follows: City Gas & Electric Co., light, $23.50; Bell Telephone Co., telephone service and telegrams, $23.30; Hydrox Co., water, $2.50.

March 3

Sold N. D. Norris & Sons, Kankakee, terms 2/10, n/60, hardware as per carbon copy of sales invoice No. 52, $124.90.

Borrowed $2,000.00 from the Merchants' National Bank on our 60-day note endorsed by Mr. Humphrey.

Bought hardware from the J. F. Reinhart Mfg. Co., Liberty Mills, per our purchases invoice No. 19, terms 2/10, n/60, $135.25.

Gave Henry Wilson a check for $25.00, in payment of garage rent for March.

Sold E. W. Burke & Co., Wheaton, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 53, hardware, $61.91; cutlery, $104.00; total of sale, $165.91.

March 4

Received check from James W. Shore, in payment of merchandise sold him February 23rd, less discount.

Sold Lang Brothers Hardware Co., Crown Point, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 54, hardware, $114.10; cutlery, $34.00; total of sale, $148.10.

March 5

Received check from A. W. White, Paxton, in payment of merchandise sold him February 24th, less discount.

Gave Dunham Advertising Agency $100.00 to apply on advertising contract.

Sold A. W. White, Paxton, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 55, hardware, $108.10; cutlery, $37.65; total of sale, $145.75.

March 6

Received checks from A. P. Barlow and E. W. Burke & Co., in payment of merchandise sold them February 25th, less discount.

Gave the McIntyre Supply Co. a check for $27.00, in payment for motor supplies.

Paid Russel Erwin Co. for merchandise purchased from them Feb. 25th, less allowance for shortage and less discount, and Henry Disston & Co., for merchandise purchased from them February 24th, less discount.

Sold Victor Price & Co., Galesburg, terms 2/10, n/60, hardware as per carbon copy of sales invoice No. 56, $141.94.

March 7

Received checks from N. D. Norris & Sons and W. H. Miller Hardware Co., in payment for merchandise sold them February 26th.

Withdrew $260.00 from the bank to pay the following: weekly pay roll, $135.00; Long and Humphrey, each $25.00 for personal use; E. D. Carpenter, expense money, $75.00.

Sold James W. Shore, Champaign, terms 2/10, n/60, cutlery as per carbon copy of sales invoice No. 57, $147.95.

March 9

Received a check from Thomas & Lake Hardware Co., in payment for merchandise sold them February 27th, less discount.

Bought hardware from Henry Disston & Co., Philadelphia, as per our purchase invoice No. 20, terms 2/10, n/60, $394.25.

E. D. Carpenter reports traveling expenses, $31.90.

Sold Lang Brothers Hardware Co., Crown Point, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 58, hardware, $122.72; cutlery, $28.80; total of sale, $151.52.

Received check in payment of trade acceptance received from E. W. Burke & Co. February 7th.

March 10

Received checks from Central Hardware Company and T. W. Richardson, in payment of merchandise sold them February 28th, less discount.

Paid J. F. Reinhart Mfg. Co. for merchandise purchased from them February 28th.

Sold A. P. Barlow, Gilman, terms C. O. D., merchadise as per carbon copy of sales invoice No. 59, hardware, $70.90; cutlery, $63.80; total of sale, $134.70. Certain information which has come to us concerning the credit of Mr. Barlow makes us unwilling to sell him on the usual terms, hence the merchandise is sold C. O. D.

When a C. O. D. sale is made by freight it is necessary to draw a draft for the amount of the sale and send this, together with the

order bill of lading, to a bank in the city in which the customer is located. It is necessary for the customer to pay the draft in order to secure the bill of lading as the railroad will not deliver the merchandise unless the consignee presents the bill of lading. This is discussed in Chapter XXIX in the text.

March 11

Received a check from the Thomas & Lake Hardware Co., in payment of merchandise sold them March 2nd, less discount.

Sold T. W. Richardson, Warren, terms 2/10, n/60, hardware as per carbon copy of sales invoice No. 60, $121.85.

March 12

Received check from N. D. Norris & Sons, Kankakee, in payment of merchandise sold them March 3rd, less discount.

Sold Thomas & Lake Hardware Company, Peotone, terms 2/10, n/60, hardware as per carbon copy of sales invoice No. 61, $227.23.

The creditors of Daniels & Hayden have agreed to accept 50% on the dollar in full settlement of their claims rather than throw them into bankruptcy. Received a check for $15.09, in full settlement of our account against them.

March 13

Received check from E. W. Burke & Co., in payment of merchandise sold them March 3rd, less discount.

Paid J. F. Reinhart Mfg. Co., for merchandise purchased from them March 3rd, less discount.

The note received from the Central Hardware Co. January 17th, will be due March 18th, and it has been left at the bank for collection.

The Hall Hardware Co. agreed to prepay their trade acceptances if we would allow them 3% discount on the balance due on account. Accepted their proposition and received check as per this agreement.

Sold James W. Shore, Champaign, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 62, cutlery, $57.90; hardware, $75.00; total of sale, $132.90.

Prove cash (balance $4,177.78).

(Continued on Page 451)

CHAPTER XXXII

SUMMARIZING AND REPORTING TRADING ITEMS ON A DEPARTMENTAL BASIS

Information Shown by Trading Accounts at End of Period

The illustration which was begun in the preceding chapter dealt with the division of the trading group of accounts on a departmental basis, and showed in very simple form the types of books of original entry which would be adapted to recording the information about trading operations in such a way as to facilitate this division. A small business was assumed to be dealing in both hardware and furniture, and it was further assumed that the management desired to ascertain the gross profits on each class of sales at the end of the period. For purposes of the illustration a small number of transactions were taken as representative of an accounting period, and these transactions were shown recorded in the books of original entry.

As the next step in the illustration of departmental trading accounts, it is proposed to show the trading accounts for this small business as they would appear after the books of original entry illustrated above had been posted. It is assumed that the merchandise inventory accounts at the beginning of the period showed balances as follows: inventory hardware, $2,270.00; inventory furniture, $2,540.00. The trading group of accounts, after the posting for the period has been done, will appear as follows:

Inventory—Hardware

			J.	2,270	00						

Inventory—Furniture

			J.	2,540	00						

Purchases—Hardware

			P. J.	950	00						

Purchases—Furniture

			P. J.	1,350 00					

Freight, Express, and Cartage Inward—Hardware

			C.	17 50					

Freight, Express, and Cartage Inward—Furniture

			C.	22 50					
			C.	24 00					

Purchase Returns and Allowances—Hardware

								P. R. A.	250 00

Purchase Returns and Allowances—Furniture

								P. R. A.	200 00

Sales—Hardware

								S. J.	990 00

Sales—Furniture

								S. J.	1,505 00

Sales Returns and Allowances—Hardware

			S. R. A	45 00					

Freight, Express, and Cartage Outward—Hardware

			C.	6 00					

Freight, Express, and Cartage Outward—Furniture

			C.	12 00					

The next step in the illustration is to show the journal entries which are necessary (1) to adjust each one of the departmental inventory accounts so it will show the correct balance at the begin-

ning; (2) to adjust the departmental purchases accounts so they will show the cost of goods sold for each department; (3) to close the balance showing the cost of goods sold out of each departmental purchases account, transferring it to the debit of the departmental sales account; (4) adjusting the sales accounts to show the gross profit on sales for each department; and (5) transferring these gross profit balances to Profit and Loss. The steps involved may be traced easily enough by following the journal entries which would appear as follows:

December 31, 1920

		Debit	Credit
	Purchases—Hardware	2,370 00	
	Inventory—Hardware		2,370 00
	To transfer the beginning inventory to the Purchases account.		
	31		
	Purchases—Furniture	2,440 00	
	Inventory—Furniture		2,440 00
	To transfer the beginning inventory to the Purchases account.		
	31		
	Inventory—Hardware	2,385 00	
	Purchases—Hardware		2,385 00
	To record the ending inventory.		
	31		
	Inventory—Furniture	2,575 00	
	Purchases—Furniture		2,575 00
	To record the ending inventory.		
	31		
	Purchases—Hardware	17 50	
	Freight, Express, and Cartage Inward—Hardware		17 50
	To transfer the cost of freight, express, and cartage inward on hardware to the Purchases account.		
	31		
	Purchases—Furniture	46 50	
	Freight, Express, and Cartage Inward—Furniture		46 50
	To transfer the cost of freight, express, and cartage inward on furniture to the Purchases account.		
	31		
	Purchase Returns and Allowances—Hardware	250 00	
	Purchases—Hardware		250 00
	To credit the Purchases account with hardware returns and allowances.		

December 31, 1920

31			
Purchase Returns and Allowances—Furniture	200	00		
Purchases—Furniture			200	00
To credit the Purchases account with furniture returns and allowances.				
31				
Sales—Hardware	702	50		
Purchases—Hardware			702	50
To transfer the cost of hardware sold to the Sales account.				
31				
Sales—Furniture	1,061	50		
Purchases—Furniture			1,061	50
To transfer the cost of furniture sold to the Sales account.				
31				
Sales—Hardware	740	00		
Sales Returns and Allowances—Hardware			740	00
To debit Sales account with hardware returns and allowances.				
31				
Sales—Furniture	45	00		
Sales Returns and Allowances—Furniture			45	00
To debit Sales account with furniture returns and allowances.				
31				
Sales—Hardware	6	00		
Freight, Express, and Cartage Outward —Hardware			6	00
To debit Sales account with cost of freight, express, and cartage outward on hardware.				
31				
Sales—Furniture	12	00		
Freight, Express, and Cartage Outward —Furniture			12	00
To debit Sales account with cost of freight, express, and cartage outward on furniture.				
31				
Sales—Hardware	241	50		
Profit and Loss			241	50
To transfer the gross profit on sales of hardware to the Profit and Loss account.				
31				
Sales—Furniture	386	50		
Profit and Loss			386	50
To transfer the gross profit on sales of furniture to the Profit and Loss account.				

After the foregoing journal entries have been made and posted, the trading group of accounts will appear as follows:

Inventory—Hardware

1		J.	2,370	00	31	To Purchases	J.	2,370	00
1		J.	2,385	00					

Inventory—Furniture

1		J.	2,440	00	31	To Purchases	J.	2,440	00
1		J.	2,575	00					

Purchases—Hardware

31		P. J.	950	00	31	Inventory	J.	2,385	00
31	Inventory	J.	2,370	00	31	Returns and Allow.	J.	250	00
31	Freight In	J.	17	50	31	To Sales	J.	702	50
			3,337	50				3,337	50

Purchases—Furniture

31		P. J.	1,350	00	31	Inventory	J.	2,575	00
31		J.	2,440	00	31	Returns and Allow.	J.	200	00
31	Freight In	J.	46	50	31	To Sales	J.	1,061	50
			3,836	50				3,836	50

Freight, Express, and Cartage Inward—Hardware

31		C.	17	50	31	Purchases	J.	17	50

Freight, Express, and Cartage Inward—Furniture

31		C	22	50	31	Purchases	J.	46	50
		C.	24	00					
			46	50				46	50

Purchase Returns and Allowances—Hardware

31	Purchases	J.	250	00	31		P. R. A.	250	00

Purchase Returns and Allowances—Furniture

31	Purchases	J.	200	00	31		P. R. A.	200	00

Sales—Hardware

31	Cost of Goods Sold	J.	702.50	31		S. J.	990.00
31	Returns and Allow.	J.	40.00				
31	Freight Out	J.	6.00				
31	To Profit and Loss	J.	241.50				
			990.00				990.00

Sales—Furniture

31	Cost of Goods Sold	J.	1,061.50	31		S. J.	$1,505.00
31	Returns and Allow.	J.	45.00				
31	Freight Out	J	12.00				
31	To Profit and Loss	J.	386.50				
			1,505.00				1,505.00

Sales Returns and Allowances—Hardware

31		S. R. A.	40.00	31	To Sales	J.	40.00

Sales Returns and Allowances—Furniture

31		S. R. A.	45.00	31	To Sales	J.	45.00

Freight, Express, and Cartage Outward—Hardware

31		C.	6.00	31	To Sales	J.	6.00

Freight, Express, and Cartage Outward—Furniture

31		C.	12.00	31	To Sales	J.	12.00

An examination of the foregoing group of trading accounts will show that the two departmental purchases accounts have been adjusted to show the cost of goods sold in the two departments, and that this amount has then been transferred to the departmental sales account in each case. The accounts subsidiary to each departmental sales account were then closed into that account, and each of the sales accounts was made to show the gross trading profit for its department. After the gross trading profit for each department has been transferred to the Profit and Loss account, all the trading accounts are closed, or at least all of them that are in the nature of revenue accounts. The departmental inventory accounts, being asset accounts, remain open, each showing the amount of the new inventory for that department.

Showing Departmental Analysis in the Reports

It is hardly necessary to point out that all this classification of information about trading operations on a departmental basis would scarcely be maintained in the books of original entry and in the accounts except for the purpose of making it possible to prepare reports showing such a classification. To complete the illustration which has been carried through the present and the preceding chapters, therefore, it is necessary to show how these items would appear in the Statement of Profit and Loss which would be prepared at the end of the period in question. Since the departmental analysis in this illustration is carried only to the extent of determining the gross trading profit by departments, only the trading section of the Statement of Profit and Loss will need to be shown. This trading statement, giving the gross profit, may be repeated for each department, or if there is room on the paper, it may be presented in a comparative form. Since there are only two departments concerned here, it is possible to use the comparative form. The statement for the business under consideration drawn up in this form will appear as follows:

BARKER AND ALEXANDER

STATEMENT OF PROFIT AND LOSS,

For the Period Dec. 1 to Dec. 31, 192..

Trading Section	Hardware		Furniture	
Gross Sales		990 00		1505 00
Less:				
Sales Ret. and Allow.	40 00		45 00	
Out Freight, etc.	5 00	46 00	12 00	57 00
Net Sales		944 00		1448 00
Cost of Goods Sold:				
Gross Purchases	950 00		1350 00	
Less:				
Purchases Ret. and Allow.	250 00		200 00	
Net Purchases	700 00		1150 00	
Add:				
Inventory (Initial)	2370 00		2440 00	
In Freight, etc.	17 50		46 50	
Total	3087 50		3636 50	
Deduct:				
Inventory (Final)	2385 00		2575 00	
Cost of Goods Sold		702 50		1061 50
Gross Trading Profit		241 50		386 50
Total Gross Trading Profit				628 00

Illustration No. 43—Statement of Profit and Loss Showing Departmental Analysis

From this point onward the Statement of Profit and Loss would not differ from the forms that have been previously illustrated.

Summary

From the discussion and illustrations in the present and preceding chapters, the student should have gained a fairly clear idea of some of the reasons why the trading group of accounts may be divided on a departmental basis. He should also have been enabled to understand something of the sort of modifications in the forms of the books of original entry that may be made to facilitate such a division of these accounts; and of the method of procedure to be followed in entering the transactions, posting them to the accounts themselves, adjusting and closing out these accounts; and finally, of presenting the information which is furnished by them in the accounting reports at the close of the period.

In a great many of the more highly organized business enterprises, departmentalization of the accounts does not stop with the trading accounts, but goes much further, and attempts, with varying degrees of success, to make it possible to report net operating profit by departments. Discussion of the problems and procedure involved in such an organization as this, however, can not advantageously be taken up at this point, but must be left for later consideration.

QUESTIONS FOR CLASS DISCUSSION

1

The Vandalia Mercantile Company (a retail store) have the following departments: men's ready-to-wear, ladies' ready-to-wear, grocery and millinery. The company desire to keep their records so as to be able to determine the gross profit received from each department. Give the accounts which will have to be maintained to make this possible.

2

If this company were a wholesale company, in what way would their trading accounts be different?

3

Explain the construction of the purchases, sales and cash records which would be required by this company.

4

Customers frequently purchase goods in two or more departments. It is inconvenient for them to make a separate payment for the goods purchased in each department. Explain how such sales may be handled so that only one payment for the total may be made by the customer.

5

Explain the journal entries which will be necessary to adjust and close the trading accounts of the Vandalia Mercantile Company at the end of the fiscal period.

6

The company decides to open a produce department in order that it may purchase the produce of its rural customers. They purchase some of the produce for cash, but in most cases the customer delivers the produce to the company and takes in exchange merchandise selected from the other departments. Most of the produce purchased will be shipped to the city markets, but some of it is sold to local customers. Give the additional accounts which will be necessary because of the establishment of the produce department.

7

At the end of the year the records show that a slight loss has resulted from the purchase and sale of produce. Does this mean that it is unprofitable to maintain this department and that it should be discontinued?

8

Explain how the profit or loss of each department will be shown on the Statement of Profit and Loss.

9

The James Department Store has four departments. In the past it has maintained separate trading accounts with each department so the gross profit from the sales of each department could be determined. The general manager decides that in the future he desires to know the *net* profit of each department instead of the *gross* profit. What will be necessary in order that he may obtain this information?

10

Do you think the general manager is correct in desiring to know the *net* instead of the *gross* profit of each department? Why do not all stores which have a departmental organization determine the *net* profit of each department?

LABORATORY MATERIAL

Practice Set No. 3—Continued

March 14

Received check from A. W. White, in payment for merchandise sold him March 5th.

Received notice from the bank that the sight draft accompanying the bill of lading for sales invoice No. 59 has been collected and deposited to our account.

Withdrew $205.00 from the bank to pay the following: weekly pay-roll, $135.00; Humphrey, $40.00, for personal use; Long, $30.00, for personal use.

Sold Gregg Hardware Company, Rochester, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 63, cutlery, $45.45; hardware, $104.94; total, $150.39.

Gave United Railways a check for $52.10 freight on hardware purchased.

March 16

Received check from Victor Price & Co. in payment of merchandise sold them March 6th.

Purchased hardware from Wickwire Brothers, Cleveland, as per our purchase invoice No. 21, terms 2/10, n/60, $293.75.

Received a check from the Jackson Hardware Co. in payment of trade acceptance received from them February 14th.

Mr. Carpenter reports traveling expenses for the week, $29.10.

Gave the Merchants' National Bank a check, in payment for the trade acceptance accepted February 13th, in favor of Muskegon Motors Co.

Sold John Hartman, Grant Park, term C. O. D., hardware as per carbon copy of sales invoice No. 64, $129.11.

See third transaction on March 10th.

March 17

Received check as follows: James W. Shore, in payment of merchandise sold him March 7th, less discount; Gregg Hardware Company, in payment of merchandise sold them January 13th.

Sold J. B. Stebbins & Co., 1121 Sherman Ave., City, terms 2/10, n/60, cutlery as per carbon copy of sales invoice No. 65, $168.25.

March 18

Received check from A. W. White, in payment of merchandise sold him January 15th.

Gave J. F. Edwards a check for $25.00 for office stationery.

Received notice from the bank that the sight draft accompanying the bill of lading for sales invoice No. 64 has been collected and credited to our account.

Sold the Central Hardware Co., 555 Milton St., City, terms 3%, 30-day trade acceptance, cutlery as per carbon copy of sales invoice No. 66, $156.53.

March 19

The bank notified us that the note left for collection on the 13th has been paid and our account credited for the amount.

Received check from Lang Brothers Hardware Co., in payment for merchandise sold them March 9th, less discount.

Paid Henry Disston & Co. for merchandise purchased from them March 9th, less discount.

Sold Lewis Hardware Co., Centralia, terms 2/10, n/60, merchandise as per carbon copy of our sales invoice No. 67, cutlery, $86.25; hardware, $187.00; total of sale, $273.25.

Received a 30-day trade acceptance from Central Hardware Co., in payment of merchandise sold them March 18th, as per terms of the sale. This acceptance was accepted March 18th, payable at Merchants' National Bank.

March 20

Bought hardware from W. D. Allen & Co., Cleveland, as per purchases invoice No. 22, terms 2/10, n/60, $706.00.

Sold W. H. Stevens, McHenry, terms 2/10, n/60, hardware as per carbon copy of sales invoice No. 68, $248.55.

Received a check in payment of the trade acceptance received from A. L. Burton January 20th.

Sold A. L. Burton, Elgin, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 69, hardware, $54.27; cutlery, $145.53; total of sale, $199.80.

March 21

Received checks as follows: T. W. Richardson, in payment of merchandise sold him March 11th, less discount; Thomas & Lake Hardware Co., in payment of merchandise sold them March 12th, less discount.

Withdrew $245.00 from the bank to pay the following: weekly pay roll, $135.00; Mr. Humphrey, for personal use, $25.00; Mr. Long, $85.00—$20.00 for personal use and $65.00 for traveling expenses of a buying trip.

Sold Fred Dole, Clinton, terms 2/10, n/60, hardware as per carbon copy of sales invoice No. 70, $233.62.

March 23

Received check from James W. Shore, in payment of merchandise sold him January 21st.

Returned to W. D. Allen & Co. a part of the hardware purchased March 20th, and received credit for $198.00.

Mr. Carpenter reports traveling expenses for the week, $32.00. Sent him a check for $50.00, additional expense money.

Sold Gregg Hardware Company, Rochester, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 71, hardware, $219.01; cutlery, $73.03; total of sale, $292.04.

March 24

Sold N. D. Norris & Sons, Kankakee, terms 2/10, n/60, hardware as per carbon copy of sales invoice No. 72, $190.47.

Gave the Merchants' National Bank a check in payment of the trade acceptance in favor of W. D. Allen & Co., accepted February 23rd.

March 25

Received check from Gregg Hardware Company, in payment of merchandise sold them March 14th, less discount.

Bought from Russel Erwin Co. hardware as per purchases invoice No. 23, terms 2/10, n/60, $394.00.

Sold Lang Brothers Hardware Company, Crown Point, terms 2/10, n/60, merchandise per carbon copy of sales invoice No. 73, hardware, $316.70; cutlery, $77.85; total of sale, $394.55.

March 26

Paid Wickwire Brothers for merchandise purchased from them March 16th, less discount.

Sold Victor Price & Co., Galesburg, terms 2/10, n/60, hardware as per carbon copy of sales invoice No. 74, $319.75.

March 27

Bought hardware from J. F. Reinhart Mfg. Co., Liberty Mills, per our purchases invoice No. 24, terms 2/10, n/60, $295.00.

Sold W. H. Stevens, McHenry, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 75, hardware, $234.50; cutlery, $48.75; total of sale, $283.25.

March 28

Sold Johnson & Lewis Hardware Co., Gary, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 76, hardware, $84.75; cutlery, $65.35.

Withdrew $195.00 from the bank to pay the following: weekly pay roll, $135.00; Humphrey and Long, each $30.00 for personal use.

Purchased from E. C. Simmons Hardware Co., St. Louis, cutlery as per our purchases invoice No. 25, terms 2/10, n/60, $630.90

March 30

Received check from A. L. Burton, in payment of merchandise sold him March 20th, less discount.

Lang Bros. Hardware Co. returned the following merchandise for credit: hardware, $17.65; cutlery, $12.80.

Paid W. D. Allen & Co. for merchandise purchased from them March 20th, less merchandise returned and less discount.

Sold A. W. White, Paxton, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 77, hardware, $265.25; cutlery, $47.85, total of sale, $313.10.

March 31

Sold Fred Dole, Clinton, terms 2/10, n/60, merchandise as per carbon copy of sales invoice No. 78, hardware, $196.00; cutlery, $53.85; total of sale, $249.85.

Received a credit bill from E. C. Simmons Hardware Co. for $29.90, cutlery returned.

Gave the United Railways a check for $74.79, in payment of freight on merchandise purchased. $24.16 of this amount is on purchases of cutlery and the remainder on purchases of general hardware.

Mr. Carpenter reports expenses for the week, $28.50.

Make the entry for the monthly salaries of the partners.

Instructions: 1. Prove cash (balance $2,560.03) and rule the cash book.

2. Post all books of original entry.

3. Take a Trial Balance of the general ledger.

4. Make a list of the Customers' and Creditors' accounts as shown by the subsidiary ledgers and compare with the controlling accounts.

(Continued on page 466)

CHAPTER XXXIII

THE USE OF PERCENTAGES AND STATISTICS IN ACCOUNTING

The Use and Value of Percentages

It has been emphasized many times in the preceding chapters that the primary function of accounting is to provide information which may be used to manage and control a business. In order to obtain such information it is necessary that accounting records be designed which will provide accurate information and that proper methods be used to present this information so that it can be used by those who are responsible for the management of the business. In previous chapters the designing of such records has been discussed and the use of the Balance Sheet and Statement of Profit and Loss as a means of presenting the information provided by such records has been explained and illustrated.

The Balance Sheet and the Statement of Profit and Loss are the two reports most frequently used by business men. There is certain information in addition to that provided by these reports, however, which is necessary in order that they may be properly interpreted. There is also other information which is often necessary in order that the operations of the business may be properly controlled previous to the time when the Balance Sheet and the Statement of Profit and Loss are prepared. For instance, the Statement of Profit and Loss at the end of the year may show that a net profit of $10,000.00 has been made during the year. The question may arise whether or not this is a satisfactory amount of profit. From the mere statement that the profit for the year is $10,000.00 it is impossible to judge whether the business has been conducted properly during the year.

In addition to knowing that a profit of $10,000.00 has been made, it is necessary, among other things, to know the amount of profit which was made during the previous year, in order to determine whether or not the business of this year has increased in proportion to the business of previous years; and it is desirable also to know whether other firms of the same size doing a similar business under similar conditions made more or less profit. If, by

consulting the Statement of Profit and Loss of the preceding year, it is seen that the net profit for last year was $8,000.00, and that the profit for this year is $10,000.00, it may appear at first glance that the business has been conducted satisfactorily during the present year. If the sales for last year, however, were $100,000.00 and the sales for this year were $200,000.00, it would not be thought that the business for the present year had been conducted efficiently since the sales had doubled, but the net profit had increased only twenty-five per cent.

It will be seen, therefore, that in interpreting information provided by accounting records it is necessary to make certain comparisons. In making these comparisons it is desirable that they be stated in such a form that they can be readily understood. It has been found by experience that a very effective way of showing such comparisons is to state them by means of percentages. For instance, in the illustration given above where the sales were $100,000.00 and the net profit $8,000.00, the profits are eight per cent. of sales; while during the next year when the sales were $200,000.00 and the net profits $10,000.00, the profits are only five per cent. of the sales.

By stating the amount of the profits for the two years in terms of percentages, it will be seen that the net profits are three per cent less in proportion to the sales than they were during the previous year. This immediately indicates that the business has probably not been conducted as efficiently during the current year as during the past year—at least as satisfactory results have not been obtained. So it is with any other comparisons when stated in terms of percentages—they are readily comprehensible to any one who may wish to read them.

It is the purpose of the present chapter to discuss the use of certain percentages as well as certain accounting statistics and the methed of determining these percentages and statistics.

Method of Determining Percentages

If percentages are to be of value, it will readily be understood that they must be calculated on a common basis. For instance, in the foregoing case it was determined that the net profits were eight per cent of the sales in one year and five per cent of the sales the following year, therefore a comparison between them can be made. However, if it is determined that profits for one year are ten per cent of the cost of goods sold and for the next year are

eight per cent of the sales, then comparison can not be made because the percentages are figured on a different basis.

There has been much argument in the last few years as to what should be used as the basis for the computation of percentages with reference to profits, expenses, etc. Some claim that the cost of the goods sold should be used as the basis, while others insist that the net sales should be considered as the basis. In most of the texts on arithmetic the student is taught that the costs should always be considered as the basis in calculating percentages. In business practice, however, the sales price is more frequently used.

During the last few years the National Association of Credit Men, Burroughs Adding Machine Company, Butler Brothers, The National Implement and Vehicle Association, and the Harvard Bureau of Business Research have prepared and distributed articles advocating the use of sales as the basis of calculating percentages. It is obvious that either may be used with accuracy if it is adhered to with consistency. The difficulty in the past has been that many merchants have used sales as a basis of calculating some of their percentages and have used cost of goods sold as the basis for calculating other percentages; consequently they have been led into errors and confusion when they attempted to use the statistics which have been calculated on different bases. This confusion constitutes the chief error encountered in actual practice.

Arguments for Using the Sales Price as the Base for Calculating Percentages

There are some advantages, however, in computing expense and profit percentages on sales rather than on the cost of goods sold. A few years ago the Burroughs Adding Machine Company published a little pamphlet written by Thomas A. Fernley giving twelve reasons why the percentage of profit should be figured on the selling price and not on the cost.

The reasons stated by Fernley are as follows:

> 1. Because the remuneration of salesmen is figured on a certain percentage of the selling price.
>
> 2. Because the percentage of expense of conducting business is based on the selling price. If you take per cent of profit on cost and per cent of expense on selling price, where are you?
>
> 3. Because the mercantile and other taxes are inevitably based on per cent of gross sales.

4. Because the sales totals are always given in books of record. Cost totals are seldom, if ever, shown.

5. Because the profit must provide for two items of capital—one the capital invested in merchandise, the other the capital necessary for operating expenses and other expenditures not properly chargeable to the merchandise account. This is only possible where profit is figured on the selling price.

6. Because it indicates correctly the amount of gross or net profit when cost of sales is stated. The percentage of profits on sales is indicative of character, a result of the use of the business—percentage of profit on cost is not.

7. Because allowances in percentage to customers are always from selling price.

8. Because no profit is made until sale is actually effected.

9. Because nine stores in ten which do not figure on the selling price get mixed somewhere in their figures and do not know whether they are going forward or backward.

10. Because the big stores figure on selling price.

11. Because it puts the retailer where a customer will not so likely call him a robber if he learns the percentage of profit. Twenty per cent. of a selling price is twenty-five per cent. on the cost, but the twenty per cent. does not seem as large an amount

12. Because if you figure on the selling price you can go to the cash drawer and say that "ten per cent. of that money is my profit" instead of having to say that "ten per cent. of the cost of the goods which I sold for that money is my profit."

In a book published by Butler Brothers, of New York, Chicago St. Louis and Minneapolis, entitled "The Butler Way System Book," there is the following statement with reference to the use of sales price as the basis of calculating percentages of expense and profit:

"Never, never figure your per cent of profit on cost. Burn this rule into your brain some way so that you will never forget it.

It will save you time, it will save you much worry, it will help you increase your net returns. Remember always that your profit comes out of your selling price and not out of the cost. You buy a thing for a dollar and place it in your stock. You buy it so you can gain a profit. Where are you going to gain this profit, out of the dollar, or out of the object itself? It is perfectly obvious you will gain no profit from this article until you sell it. Then you sell it, say, for $1.50; you paid fifty cents less for it. This fifty cents is part of the $1.50 you get for the thing, not part of the dollar you paid for it. The fifty cents represents your gross profit—gross profit on the sale. And since it is the sale that pays the profit, it is obvious that the sale is the logical basis upon which to figure the profit."

Important Considerations in Figuring Percentages

As indicated previously, the most important consideration in figuring percentages is that they all be calculated on the same basis whether that basis be the sales price or cost of goods sold, and that they be figured accurately. Many a merchant goes wrong on the question of figuring his profits not only in his percentage calculations, but also because he uses one basis in making some percentages and another basis in making other percentages. Although it seems quite easy to one accustomed to making mathematical percentages to figure them accurately, many business men make errors in connection therewith.

A few years ago a certain manufacturer sent out broadcast to retailers of all classes an invitation to solve this problem:

> "A certain article costs one dollar, wholesale, including freight. What will it have to be sold for to bring a net profit of twelve per cent. after allowing eighteen per cent. for the cost of doing business?"

About one thousand retailers sent in solutions. The answers varied from $1.12 to $1.60. It can be seen, therefore, from this illustration that many business men are apt to figure their costs and profits incorrectly.

Methods of Calculating Percentages

The problem given in the foregoing paragraph may be used as a means of illustrating the method of calculating percentages correctly. If the sales price is to be used as the basis for calculating

percentages, the article must be sold for $1.43. The method of obtaining this amount may be shown in tabulated form as follows:

Selling Price		100%
Cost of Doing Business	18%	
Desired Net Profit	12%	
Selling Cost and Profit		30%
Wholesale Cost		70%

The wholesale cost is 100 cents, or seventy per cent. of the selling price. Divide 100 cents by 70 and you get $1.43 for the selling price of the article.

The above process stated in the form of a rule is as follows:

> "To find the selling price of an article add together the cost of doing business and the desired net profit. Deduct this from 100. Divide the result into the cost price."

If, in the foregoing illustration, it is desired to use the cost of the goods sold as a basis, the selling price of the article would be $1.30. This is obtained by adding the eighteen per cent. constituting the cost of doing business and the twelve per cent. representing the net profit desired, which will give a total of thirty per cent. of the cost price, which must be added to obtain the selling price. Thirty per cent. of one dollar, the cost price, equals thirty cents. One dollar, or the cost price, plus thirty cents, equals $1.30, the selling price.

It will be seen from the foregoing illustration that it makes considerable difference in the calculation of selling price whether the cost or selling price is used as a basis. Of course, if it is desired that the article sell for $1.43 and it is also desired that the cost of the article be used as a basis, it is necessary that the percentages of the cost of doing business and profit must be changed.

References on Methods of Calculating Costs

Frank E. Goodman, in an article entitled "The Cost Accounting Fallacy Exposed," published in the *American Paint and Oil Dealer* for June, 1912, presents an argument for the use of the cost of goods sold as a basis for the calculation of percentages.

Arguments for the use of the selling price as the basis can be found in the pamphlet published by the Burroughs Adding Ma-

chine Company, to which previous reference has been made; in various pamphlets which have been published by the National Association of Credit Men; in Nystrom's "Economics of Retailing," "The Butler Way System Book," published by Butler Brothers, and in pamphlets published by various business associations.

Important Percentages with Reference to Profits and Expenses

There are many percentages with reference to profits and expenses which are of importance. Some of those which are most important are the ratio between sales and the cost of goods sold, the ratio between selling expenses and sales, between buying expenses and sales, between delivery expenses in the case of a retail business and sales, between administrative expenses and sales, between gross profits and sales, and between net profits and sales.

Such percentages as those mentioned may be very valuable to a particular business concern in the making of comparisons between months or years, also between different departments in its own business, and also between its own business and other businesses engaged in the same lines, if such statistics are available. For instance, it would be quite significant if a particular retail business found that its sales for one year were $100,000.00 and its delivery expenses were $1,000.00, or one per cent., while the next year its sales were $110,000.00 and its cost of delivering goods to customers was $2,200.00, or two per cent. The concern would immediately desire to investigate to find out why the ratio of the percentage to sales was twice as much the second year as the first year. It would also be of considerable significance to this business for it to find its delivery expense was two per cent. of sales, while the expense of a competitor engaged in the same line in the same city was only one per cent. of the sales

Many other similar comparisons will occur quite readily to the student. Some of the more important of these comparisons which may be stated in terms of percentages are indicated in the accompanying laboratory exercises.

Method of Showing Percentages

One of the most prevalent methods of showing percentages such as those discussed above is by indicating them on the Statement of Profit and Loss. In such cases it is customary to indicate the percentages by means of an additional column on the Statement of Profit and Loss which usually appears just to the right of the totals of the various items.

The sales price is treated as one hundred per cent; the cost of goods sold, the gross profits, the various items of expense, and the net profits are indicated as a per cent of the sales. The method of showing percentages in this manner is indicated in the Statement of Profit and Loss given in Illustration No. 44.

JAMES O'CONNER,
STATEMENT OF PROFIT AND LOSS FOR YEAR ENDING
December 31, 192..

					Per cent of Sales
Gross Sales			25000	00	100
Less: Sales Returns			1000	00	.04
Net Sales			24000	00	.96
Inventory, Jan. 1, 192. ...... 2500 00					.10
Purchases 19500 00	22000	00			.78
Less: Less Inventory at End of Year	4000	00			.16
Cost of Goods Sold			18000	00	.72
Gross Profit on Sales			6000	00	.24
Operating Expenses:					
Buying Expenses	200	00			.008
Selling Expenses	1500	00			.06
Delivery Expenses	500	00			.02
Administrative Expenses	1800	00			.072
Total Operating Expenses			4000	00	.16
Net Profit on Sales			2000	00	.08
Non-operating Income			75	00	.003
Gross Income			2075	00	.043
Non-operating Expense			50	00	.002
Net Income			2025	00	.08

Illustration No. 44—Statement of Profit and Loss Showing Percentages

The Meaning and Importance of Turnover

As stated at the beginning of this chapter, there are various kinds of statistics which are of value in the control and management of a business. Some of the important statistics which may be represented by means of percentages are stated and illustrated in the preceding paragraphs. Another kind of statistics which is very important is that with reference to turnover.

With reference to a particular article it may be determined that the net profit is five per cent, but to know that the profit is five per cent is not sufficient. It must further be determined how long it is from the time the article is purchased to when the article is sold. If, on the average, the article remains in stock six months after it is purchased before it is sold, only one-half as much profit will be made in connection with this article as if it were sold in three months after it is purchased. This should be seen readily, for in the first case the article could be bought and sold only two

times during the year, therefore only ten per cent. profit will be made on it; in the second case, the article can be purchased and sold four times during the year, and therefore a twenty per cent. profit will be made.

It can, therefore, be seen that it is much more profitable to sell an article which on the average remains in stock only three months than to sell an article which remains in stock six months. Hence it is quite important for the merchant to determine the number of times that an article can be purchased and sold within a year. The number of times an article can be sold or turned over within the year is known as the turnover, and the calculation of the number of times it can be purchased and sold during the year is termed the calculation of turnover.

Method of Calculating Turnover

In practice it will be found that several methods are used in the determination of merchandise turnover. There are, in fact, but two methods of determining turnover accurately. They are as follows:

1. Divide the cost of the goods sold during the year by the cost of the average inventory of the year. For instance, a retail store carries on the average a stock of goods the cost price of which is $20,000.00, and makes during the year sales of $100,000.00, on which a gross profit of twenty per cent. is made. The cost of goods sold is $80,000.00 and the turnover is four.

In other words, in this store, on an average, the articles sold remain in stock three months after they are purchased before they are sold. It will, of course, be realized that it is rather dangerous to try to determine the one turnover for all the goods carried in stock. It is more accurate to determine if possible the turnover for each kind of goods, since the turnover varies on each kind.

2. The turnover may be determined by dividing the average inventory for the year at sales price into the sales at sales price. For instance, taking the illustration given above, where the average inventory at cost is $20,000.00 and the sales for the year are $100,000.00, on which an average gross profit of twenty per cent. is made: if the inventory is taken at sales price, it will be seen that it will amount to $25,000.00, and dividing the total sales of $100,000.00 by $25,000.00, a turnover of four will be obtained.

It will be seen that the same result is obtained as in the first case where the inventory at cost was divided into the sales at cost. Either method can be used, whichever is the more convenient.

QUESTIONS FOR CLASS DISCUSSION

1

The Statement of Profit and Loss of the Brown Department Store shows a net profit of $400,000.00 has been made during the year 1919. Does this indicate that the year of 1919 has been an exceedingly prosperous year for this store and does it also indicate that this store has been managed efficiently during the past year?

2

A further analysis of the operations of the Brown Department Store shows that in Department A profits of $50,000.00 have been made during the year, while in Department B profits of $150,000.00 have been made, in Department C $120,000.00 and in Department D $100,000.00. Can you determine from these figures which department is the most profitable, or which of the departmental managers is the most efficient? Why?

3

You desire to make a comparison between the gross sales and the net profits of one hundred different firms. You have these first listed and their gross sales shown in the one column and their net profits shown in a second column. Would you be able easily to make a comparison of these items by a statement in this form? In what form may you state the comparison in order to make it more useful?

4

The Brown Mercantile Company state that their net profits for the past year are ten per cent of their gross sales. The Smith Mercantile Company state that their net profits are fifteen per cent. of the cost of goods sold. Can you make a proper comparison between the statistics provided by these stores?

5

The Brown Manufacturing Company assert that percentages should always be figured on the selling price, while the Smith Mercantile Company argue that percentages should always be based on the cost of goods sold. State which you think is correct and give reasons for your answer.

6

An article is purchased by the X Company at a cost of $3.00. Assuming that it is desired to obtain a profit of ten per cent and that the cost of doing business for this company is twenty per cent, explain at what price the article must be sold: first, if the cost of the article is used as a basis, and, secondly, if the selling price of the article is used as a basis.

7

State some of the more important percentages which may be used in judging past results in the making of future plans.

8

How may percentages with reference to expenses and profits be shown in convenient form?

9

Explain the meaning and importance of turnover.

10

Explain and illustrate two methods of calculating turnover.

LABORATORY MATERIAL

Practice Set No. 3—Continued

Instructions: 1. The following adjustments are to be made:

(1) Reserve for Bad Debts ½ of 1% of Accounts Receivable.

(2) Depreciation on Fixed Assets:
- (a) Furniture and Fixtures, 1%.
- (b) Stockroom Equipment, 1%.
- (c) Delivery Equipment, 1%.

(3) Accruals:
- (a) Wages for one-third of a week are accrued.
- (b) Light for March, $22.00; Telephone Service and Telegrams, $20.00; Water, $3.00.

(4) Inventories are as follows:
- (a) Hardware, $11,165.27.
- (b) Cutlery, $2,209.89.
- (c) Office Supplies, $20.00.
- (d) Shipping Supplies, $10.00.
- (e) Prepaid Insurance on Truck, $21.00.
- (f) Prepaid Insurance on Merchandise, $112.50.

(5) Receiving and Shipping Expense is to be apportioned equally between Freight, Express and Cartage In and Freight, Express and Cartage Outward. In each case three-fourths will be charged to the hardware department and one-fourth to the cutlery department.

(6) Delivery Expense is to be apportioned equally between Freight and Cartage In and Freight and Cartage Outward. In each case three-fourths will be charged to tne hardware department and one-fourth to the cutlery department.

2. Prepare a Working Sheet, Balance Sheet, and Statement of Profit and Loss. Show Freight and Cartage Outward as a deduction from Sales on the Statement of Profit and Loss. See Illustration No. 43, page 447.

3. Make the journal entries necessary to give effect to the adjustments stated above and post same.

4. Make the journal entries necessary to close the ledger accounts and post same.

5. Make the post-closing entries.

6. Make a post-closing Trial Balance.

(Concluded on Page 480)

CHAPTER XXXIV

FINANCIAL REPORTS

Definition and Purpose

A financial report may be defined as any report or statement which presents financial facts or statistics. Financial statistics are those which relate either directly or indirectly to business transactions. A business enterprise is performing transactions continuously. The results of these transactions are expressed statistically in a more or less formal way in the accounting records. They are usually expressed to a certain extent in a more informal way in certain supplementary and memorandum records. In order that these statistics may be available and understandable for the use of those responsible for the management of the business, they are summarized and classified by means of financial reports or statements. The need and use of such reports have been emphasized constantly in previous chapters. The purpose of the present chapter is to explain certain modifications of the reports previously discussed and to explain and illustrate the nature and purpose of certain additional reports.

The Conventional Financial Reports

The two reports most frequently made are the Balance Sheet and the Statement of Profit and Loss. In fact, in the past these were the only two reports which were usually prepared from the accounting records. Accountants often failed to realize that the business man needed any information in addition to that provided by these two reports, and in many cases the business man failed to realize that his accounting records provided information other than that presented by the Balance Sheet and Statement of Profit and Loss. In the past few years, however, business men have found that they need information in addition to that provided by the conventional financial reports, and accountants have attempted to meet this need in two ways:

1. By making certain modifications and additions to the conventional reports.
2. By preparing additional accounting and statistical reports.

It is the purpose of the present chapter to discuss and illustrate these additions and modifications.

Exhibits

An *exhibit,* from an accounting viewpoint, is a summarized statement of material facts with reference to the financial condition of the business. The accountant usually prepares three exhibits with reference to the business:

1. The Balance Sheet, which is usually designated as Exhibit A.
2. The Statement of Profit and Loss, which is usually designated as Exhibit B.
3. An Analysis of the Surplus Account, which is usually designated as Exhibit C.

If other exhibits are prepared they are designated alphabetically.

The tendency at the present time is to make the exhibits mentioned brief and condensed so that a bird's-eye view of the financial condition of the business can be obtained from them. The individual items which compose the totals shown on the exhibits are provided by means of supplementary statements which accompany the exhibits as explained in the following paragraphs.

Schedules

A schedule is a detailed list showing the items which compose a total shown on an accounting report. Schedules are usually prepared in connection with the Balance Sheet. They are usually designated by numbers, being numbered consecutively. Schedules may be used to provide detailed information with reference to the cash balance, the notes receivable and payable, the accounts receivable and payable, or any other item on the Balance Sheet the composition of which is deemed to be of importance. It is customary to indicate on the Balance Sheet that a schedule accompanies the Balance Sheet by placing the number of the schedule immediately after the item to which it pertains. For instance, the John Brown Company may have a cash balance of $4,240.00 at the time their Balance Sheet is prepared. This amount may be represented by deposits in two banks, by a petty cash fund, and by a cash balance in the hands of a branch office. On the Balance Sheet the cash balance may be shown as follows:

Cash (Schedule No. 1) $4,240.00

Schedule No. 1, which will be attached to the Balance Sheet, will appear as follows:

SCHEDULE No. 1

The Cash Balance

Mercantile Trust Company	$1,860.00
First National Bank	1,682.40
Petty Cash Fund	100.00
St. Louis Branch Office	597.60
Total	$4,240.00

Other schedules with reference to other items on the Balance Sheet would be shown in the same manner as the schedule with cash.

Analytical Statements

In many cases the terms "analytical statement" and "schedule" are used synonymously. The analytical statement, however, is more properly used in connection with a statement which gives a more detailed analysis than that provided by a schedule. Consequently, analytical statements are used more frequently in connection with the analysis of some item appearing on the Statement of Profit and Loss, such as an expense account. For instance, if all selling expenses are debited to one account termed Selling Expenses and shown under this heading on the Statement of Profit and Loss, an analytical statement may be made which will provide an analysis to show of what the selling expenses consist. Analytical statements are numbered in consecutive order and are referred to on the Statement of Profit and Loss in the same manner that a schedule is referred to on the Balance Sheet. To illustrate: It may be assumed that the selling expenses of the John Brown Company for the year are $16,280.00, and that this item includes the amounts spent for advertising, for salaries of salesmen, for traveling expenses of salesmen, and for miscellaneous selling expenses. On the Statement of Profit and Loss the selling expenses may be shown as follows:

Selling Expenses (Analytical Statement No. 1)	$16,280.00

Analytical Statement No. 1, which will be attached to the Statement of Profit and Loss, will appear as follows:

ANALYTICAL STATEMENT No. 1

Analysis of Selling Expenses

Advertising	$ 3,142.45
Salaries of Salesmen	7,284.55
Expenses of Salesmen	4,146.78
Miscellaneous Selling Expenses	1,706.22
Total Selling Expenses	$16,280.00

Of course in many cases a more detailed analysis than is provided by the foregoing statement will be desired.

There is no uniformity in the use of the schedule and the analytical statement. Some accountants do not make use of the term analytical statement and consequently they term as schedules all statements supplementary to the Balance Sheet and the Statement of Profit and Loss. The use of these terms in the manner explained and illustrated above, however, is logical and in conformity with current practice.

The Comparative Balance Sheet

The Balance Sheet may be said to be a picture of the financial condition of a business at a particular time. If pictures of the financial condition at two or more times may be had so a comparison can be made, certain changes usually may be seen which will indicate certain tendencies. For instance, if a Balance Sheet of a business made at the beginning of the year can be compared with a Balance Sheet of the same business prepared at the end of the year, the changes which have taken place in its assets, liabilities and proprietorship can be seen, and often these changes indicate whether the business is becoming more prosperous or less so. Business men have found by experience that such comparisons are quite valuable. In order to facilitate the making of such comparisons, the accountant prepares a formal report known as the *comparative Balance Sheet*. In form the comparative Balance Sheet is as shown in Illustration No. 45.

JAMES CANNING

Comparative Balance Sheet, December 31st.

ASSETS	1919		1920	
Current Assets—				
Cash		1,800.00		1,500.00
Notes Receivable		150.00		500.00
Accounts Receivable	2,350.00		2,900.00	
Less: Reserve for Bad Debts..	50.00	2,300.00	68.00	2,832.00
Merchandise Inventory		3,500.00		4,050.00
Total Current Assets........		7,750.00		8,882.00
Fixed Assets—				
Delivery Equipment	650.00		950.00	
Less: Reserve for Depreciation	130.00	520.00	270.00	680.00
Store Equipment	725.00		725.00	
Less: Reserve for Depreciation	36.25	688.75	72.50	652.50
Office Equipment	275.00		275.00	
Less: Reserve for Depreciation	13.75	261.25	27.50	247.50
Building	6,000.00		6,000.00	
Less: Reserve for Depreciation	180.00	5,820.00	360.00	5,640.00
Land		4,000.00		4,000.00
Total Fixed Assets..........		11,290.00		11,220.00
Total Assets		19,040.00		20,102.00
LIABILITIES AND PROPRIETORSHIP				
Current Liabilities—				
Wages Accrued	50.00		65.00	
Notes Payable—Bank	1,000.00			
Notes Payable—Trade Creditors..	200.00		300.00	
Accounts Payable	800.00		1,000.00	
Total Current Liabilities.....		2,050.00		1,365.00
Total Liabilities		2,050.00		1,365.00
Proprietorship—				
James Canning—Net Worth.....		16,990.00		18,737.00
Total Liabilities and Proprietorship.		19,040.00		20,102.00

Illustration No. 45—Comparative Balance Sheet

There are no very striking changes shown by the comparative Balance Sheet of James Canning, and, in fact, striking changes in the assets, liabilities and proprietorship are not to be expected in the case of a normal business. The fact that appears most prominently on the comparative Balance Sheet of Canning is that the proprietorship or net investment has increased from $16,990.00 to $18,737.00. This indicates that a profit of $1,747.00 has been made

during the year. This is on the assumption, of course, that no additional investment has been made during the year and that there have been no withdrawals of capital. The profits of $1,747.00, representing a return of approximately ten per cent on the average investment of the year, therefore, may be considered as satisfactory. All of the current assets with the exception of cash have increased somewhat during the year. This would seem, however, to be but a normal increase and such as would be expected in a growing business. The increased inventory probably indicates an increase in volume of sales, which necessitates a larger stock on hand. This indication should be verified by a comparison of the sales of the year with the sales of the previous year. If the sales have not increased, but the inventory has, it may indicate an accumulation of unsalable goods, or that large and probably unwise purchases may have been made.

An examination of the fixed assets shows that the normal amount of depreciation has been charged off. The increase in the value of the delivery equipment indicates an increase in the volume of sales which, as stated above, is also indicated by the increased inventory. The accuracy of this indication can be determined by a comparison of the sales of the present year with those of the past year.

An examination of the liabilities shows that the bank loan has been paid and that this has been accomplished without any undue increase in the accounts payable or notes due to trade creditors. The ratio of current assets to current liabilities is over six to one, so is exceedingly favorable. In most cases a ratio of two to one is regarded as satisfactory. This ratio has also improved during the year, since it was approximately three to one at the beginning of the year.

Lastly, the proprietorship or net worth is exceedingly large in proportion to the assets, which indicates that the owner has sufficient capital with which to conduct his business without relying to any great extent on creditors to furnish capital. It also indicates that the business is capable of considerable expansion without being cramped for capital.

The general conclusion that would naturally be drawn from such an examination is that the business has been increasing in volume and on a favorable basis. The latter is borne out by the change in proprietorship. The former is indicated by the comparative Balance Sheet, but can be determined more clearly from a comparative Statement of Profit and Loss such as is illustrated and discussed later in this chapter.

A comparative Balance Sheet such as that shown in Illustration No. 45 should be of material benefit to the proprietor. If he desires to secure credit from his bank such a report will be of aid in securing it, for from a study of it the bank can see that his financial condition is such as to merit a loan. By studying this comparative Balance Sheet, together with the comparative Statement of Profit and Loss discussed below, the proprietor is able not only to judge quite accurately the results of the operations of the past year, but also to make plans with reference to the following year. It is, therefore, a valuable report for the purpose of business management.

The Comparative Statement of Profit and Loss

In the same manner that the comparative Balance Sheet is of value in determining the financial condition of a business, the comparative Statement of Profit and Loss is of value in determining the results of the operations of the business. Any kind of statistics is of more value when a comparison is involved, for absolute statements of fact are never so significant as when some basis for comparison is supplied. This is particularly true of the statistics shown on the Statement of Profit and Loss. These statistics are supposed to show the efficiency with which the business has been conducted —and efficiency is to a considerable extent a relative matter. For instance, the comparative Balance Sheet of James Canning shows that he has made a profit of $1,747.00, or approximately ten per cent, on his average investment for the year. This in itself seems to indicate that the business has been conducted efficiently during the year, but if previous Statements of Profit and Loss show that an average income of twenty per cent. has been made, it would seem that the past year's operations probably have not been conducted as efficiently as the operations of previous years. Of course, there may be other causes for the decrease in profits. In any case, it will be desirable to make a comparison of the Statement of Profit and Loss of this year and one or more previous years in order to see the cause for the decrease in profits.

Not only is the comparative Statement of Profit and Loss of value in judging the efficiency of operations, but it is also of value in interpreting the Balance Sheet, as has been indicated several times in the discussion of the comparative Balance Sheet.

In form the comparative Statement of Profit and Loss is as shown in Illustration No. 46.

JAMES CANNING

Comparative Statement of Profit and Loss for Two Years Ending December 31, 1919

	1918		1919	
Gross Sales	25,000	00	41,000	00
Less: Sales Deductions	1,200	00	1,000	00
Net Sales	23,800	00	40,000	00
Inventory, Beginning of Year	3,000	00	3,500	00
Purchases	18,200	00	31,000	00
	21,200	00	34,500	00
Less: Inventory at End of Year	3,500	00	4,050	00
Cost of Goods Sold	17,700	00	30,450	00
Gross Profit on Sales	6,100	00	9,550	00
Operating Expenses:				
Buying Expenses	261	80	390	15
Selling Expenses	1,701	70	3,035	98
Delivery Expenses	654	50	975	37
Administrative Expenses	2,618	00	3,406	50
Total Operating Expenses	5,236	00	7,808	00
Net Profit on Sales	864	00	1,742	00
Non-Operating Income	78	00	112	00
Gross Income	942	00	1,854	00
Non-Operating Expense	91	00	107	00
Net Income	851	00	1,747	00

Illustration No. 46—Comparative Statement of Profit and Loss

The comparative Statement of Profit and Loss given in Illustration No. 46 is brief and condensed so that the essential facts may be shown clearly. If a great mass of detail is shown it is apt to be confusing. Consequently several items, such as sales deductions, non-operating income and non-operating expense, are shown in total, an analysis of which may be desired. If they are small in amount, however, the totals are usually sufficient for comparative purposes.

A study of the comparative Statement of Profit and Loss given in the illustration will provide considerable information which is of value in determining the financial condition of the business of James Canning. In the first place, it will be noticed that there has been a material increase in sales, which shows that the increased inventory as shown by the comparative Balance Sheet is justified. Although the sales have increased greatly, the sales deductions have

decreased, which indicates that better service is being provided the customers, since they are returning fewer goods and claiming fewer allowances. The gross profit on sales has increased from $6,100.00 to $9,550.00, which at first glance seems very favorable; but if a comparison is made between the ratio of the gross profit and the sales of each year, it will be seen that the gross profit has not increased in proportion to the sales. In 1918 the gross profit was twenty-four per cent of the gross sales. Although it is slightly less in 1919, the difference is so slight as not to be of material importance.

A comparison of the operating expenses shows that they have increased from $5,236.00 in 1918 to $7,808.00 in 1919. This shows a considerable increase, but in view of the increased volume of business a considerable increase in expense is to be expected. The important question is whether they have increased more or less in proportion to the volume of business done. This can be determined by comparing the ratio of expenses to sales during each year. In 1918 the operating expenses were 20.9 per cent of sales, while in 1919 they were approximately 19 per cent. This indicates a very favorable tendency, since it shows that the expenses tend to decrease in proportion as the volume of business increases. If, as the business continues to increase, the percentage of expenses to sales continues to decrease, it will, of course, mean a corresponding increase in net profits.

A final comparison which is of the utmost importance is the ratio of net profit on sales to sales. The net profit has increased from $851.00 in 1918 to $1,747.00 in 1919. Expressed in terms of percentages, the net profit on sales was 3.4 per cent. of sales in 1918 and 4.3 per cent. of sales in 1919. It can be seen, therefore, that the net profit on sales has increased not only absolutely, but relatively. This indicates that a further increase in the volume of business will probably be desirable.

If desired, a comparison of nonoperating income and of nonoperating expenses may be made in terms of ratio to sales, but in the present case their amount is so immaterial that such a comparison is unnecessary. A comparison of the net income for the two years may also be made, but in this case it varies so slightly from the net profit that such a comparison would have little significance.

The comparative Statement of Profit and Loss affords the basis for many other comparisons, but the illustrations given should be sufficient to indicate its importance as a financial report.

The Statement of Receipts and Disbursements

In many cases a statement of the cash receipts and the cash disbursements is of value. Since the development of modern accounting practice, which affords more detailed statistics with reference to the business, this statement is not regarded as important as formerly. It is still quite valuable, however, when used in connection with the other financial reports.

The statement of cash receipts and disbursements is quite simple in form and needs little description or explanation. If made in comparative form its value is usually increased. It should begin with the balance on hand at the beginning of the period, show in classified form the receipts, the total of the beginning balance and the receipts, classified disbursements, and the balance on hand at the end of the period. In form it may be as shown in Illustration No. 47.

THE BROWN-SMITH MERCANTILE CO.

Statement of Receipts and Disbursements for the Month Ending June 30, 1919

Balance May 31, 1919			22,150	00
Receipts:				
Accounts Receivable	85,000	00		
Cash Sales	20,000	00		
Notes Receivable	10,000	00		
Interest on Notes Receivable	500	00		
Sale of Furniture	450	00		
Miscellaneous	1,500	00		
Total Receipts			117,450	00
Total Accountability			139.600	00
Disbursements:				
Accounts Payable	75.000	00		
Notes Payable	30,000	00		
Interest on Notes Payable	1,500	00		
Operating Expenses	7,500	00		
Non-Operating Expenses	3.000	00		
Purchase of Office Equipment	800	00		
Total Disbursements			117,800	00
Balance June 30, 1919			21,800	00

Illustration No. 47—Statement of Receipts and Disbursements

QUESTIONS FOR CLASS DISCUSSION

1

The general manager of the American Machine Company asks the auditor of the company for the following reports:

(a) An analysis of sales for 1920 according to the lines of goods sold.

(b) An analysis of sales for 1920 according to departments.

(c) An analysis of sales for 1920 according to salesmen.

Are these financial reports? Why or why not?

2

The following represents the Balance Sheet of E. W. Williams on December 31, 1919:

Cash	10,000	00	Current Liabilities	5,000	00
Other Current Assets	20,000	00	Fixed Liabilities	10,000	00
Fixed Assets	20,000	00	Proprietorship	35,000	00
	50,000	00		50,000	00

Mr. Williams desires to have an analysis of the cash on hand so that he may know the amount on deposit with different banks, the amount in petty cash drawer, and the amount in the hands of agents. Explain how such an analysis may be provided for Mr. Williams and state what the report showing this analysis would be called.

3

Assume that the customers of Mr. Williams owe him $10,000.00 and he desires to know the individuals who owe him and the amount owed by each. Explain how he may be provided with this information.

4

On the Statement of Profit and Loss of E. W. White, retail merchant, selling expenses are stated at $1,000.00. Mr. White desires to have an analysis of this item so he may determine for what purposes this expenditure has been made. Explain how this analysis may be provided for Mr. White and state what a report providing this analysis would be termed.

5

James Smith, retail merchant, in examining his Statement of Profit and Loss for 1920, finds that delivery expenses are $1,250.00, which is an increase of $400.00 over the year of 1918. Since his sales have not materially increased, he is puzzled over the reason his delivery expenses have increased so much. Explain what kind of a statement might be made for Mr. Smith which might enable him to see the cause for this increase.

6

The James Barnhart Mercantile Company present a Balance Sheet of their business to the Commercial Bank and request a loan. When the treasurer of the company presents the Balance Sheet to the bank he states that its financial condition has greatly improved during the past year. In what way may the credit manager of the bank determine the accuracy of the treasurer's statement?

7

W. E. Wales, a hardware dealer, notices on his comparative Balance Sheet for the years 1919 and 1920 that notes receivable have increased 15 per cent. and accounts receivable have decreased 10 per cent. What may this indicate?

H. I. King finds from his comparative Balance Sheet and compartive Statement of Profit and Loss that his inventory of merchandise on January 1, 1920, is 15 per cent. larger than on January 1, 1919. His sales for the year 1919 have not increased over the sales of the previous year. What may the foregoing facts indicate?

9

What would an increase of from two to one, to three to one in ratio of current assets to current liabilities as shown on the Balance Sheet of Jones & Wood indicate to their bankers?

10

On the comparative Balance Sheet of Irving Baker, notes payable show an increase of 20 per cent., while accounts payable show a decrease of 10 per cent. What may this indicate and what information would you desire to have in order to determine what it indicates?

11

The Statement of Profit and Loss of James Baker for the year 1919 indicates that he has made a net profit of 10 per cent on his investment for the year. Does this prove that Baker has conducted his business efficiently during the year?

12

A comparative Statement of Profit and Loss is prepared for Baker and it shows that during the two preceding years his profits have been 20 and 15 per cent, respectively. What would this indicate with respect to Baker's business?

13

A. R. Miller's comparative Statement of Profit and Loss shows that in 1919 sales have increased 40 per cent., but profits have decreased 10 per cent. What might be the cause of this condition? Explain how you would determine the cause and how you would show this cause to Miller.

14

H. C. Bowen finds that his operating expenses for the year 1919 are 20 per cent. more than they were in 1918. However, his operating expenses for the year 1918 were 18 per cent of his gross sales, while in 1919 they were 14 per cent of his gross sales. What do the foregoing facts indicate?

15

Explain the construction of the Statement of Receipts and Disbursements and state when it may be of value.

LABORATORY MATERIAL

Practice Set No. 3—Concluded

1. Using the Statement of Profit and Loss prepared March 31st, prepare a statement showing percentages as in Illustration No. 44.

Exercise No. 92

From the following Trial Balances taken from the ledger of H. F. Ford & Co. after all adjusting entries were posted, prepare a comparative Balance Sheet and a comparative Statement of Profit and Loss. Profits or losses are shared equally by the partners:

	September 30		October 31	
Cash	1,506.38		1,322.57	
E. W. Lytle, Proprietor		1,500.00		2,239.32
E. W. Lytle, Personal		55.30	63.20	
W. R. Hamilton, Proprietor		1,500.00		2,239.31
W. R. Hamilton, Personal		89.75	20.10	
H. F. Ford, Proprietor		2,000.00		2,500.00
H. F. Ford, Personal		50.00	6.65	
Merchandise Inventory	5,000.00		6,000.00	
Purchases	5,290.82		6,242.27	
Purchases Discount		151.56		256.11
Freight In	2,749.48		1,662.24	
Sales		10,025.08		10,589.43
Sales Discount	59.68		136.63	
Sales Returns	5.50		5.53	
Administrative Expenses	874.83		677.55	
Selling Expenses	374.34		269.21	
Interest		6.25		4.23
Loss on Bad Debts	27.21		21.53	
Office Equipment	466.50		619.50	
Reserve for Depreciation of Office Equip.		23.33		54.31
Store Fixtures	204.00		232.00	
Reserve for Depreciation of Store Fixt.		10.20		21.80
Delivery Equipment	450.00		830.00	
Reserve for Depreciation of Del. Equip.		45.00		71.50
Notes Receivable	1,000.77		1,362.97	
Notes Payable		1,565.30		1,100.29
Reserve for Bad Debts		27.21		44.65
Prepaid Insurance	63.94		57.75	
Accrued Assets	66.19		143.75	
Office Supplies	16.00		9.50	
Accrued Wages		153.34		151.93
Accounts Payable		3,674.64		2,563.34
Accounts Receivable	2,721.32		2,153.27	
	20,876.96	20,876.96	21,836.22	21,836.22

CHAPTER XXXV

THE GRAPHICAL METHOD OF PRESENTING ACCOUNTING FACTS

Need of Additional Forms of Reports

In previous chapters considerable emphasis has been placed on the value of accounting reports to the business manager. Illustrations of such reports have been presented and discussed, and attention has been given to the means to be employed in gathering the data necessary for their preparation. In the earlier chapters of this text, the discussion has been confined to the two best known and most widely used forms of accounting reports: the conventional Balance Sheet and Statement of Profit and Loss.

In Chapters XXXIII and XXXIV it has been emphasized that in presenting accounting statistics so that they may be used as a basis of business management, it is desirable that certain analysis and comparisons be made. In Chapter XXXIII the showing of comparisons by means of percentages has been explained and illustrated. In Chapter XXXIV the method of making certain analysis has been explained in connection with the discussion of schedules and analytical statements, and the methods of making comparisons have been illustrated and discussed in connection with the Comparative Balance Sheet and the Comparative Statement of Profit and Loss.

It is scarcely necessary to point out, however, that the forms of reports previously discussed have been employed only as types of the whole group of accounting reports which may be used as an aid to the business executive. There are many others that are valuable aids to the management, the number and kinds of such reports depending in each case upon the nature and the organization of the business for whose use they are designed. With the growth in size of the typical business unit, and the development of specialization within each, a need has arisen for a greater number of special reports. An example of this is to be found in the reports which are drawn up to show sales analysis. These reports must be prepared in such a way as to show an analysis of sales. They must answer the questions which may be asked by the different functional managers. Thus the merchandise man, or purchase manager, might want

a report classifying sales by commodities; while the treasurer, whose problem is financial, might desire a report on sales which would classify them by the terms of credit on which the sales were made. Not only are reports of this nature required, but also statements which make comparisons of such facts possible between branches or departments of a business, and as between different periods of time.

Use of Statistical Method

If these reports are to present the executives with the information most desired by them and in the most available form, the accountant will need to call to his aid methods of presentation which are ordinarily called *statistical* methods. The statistical method in its best sense implies the gathering, in the form of figures or numbers, of information needed to answer a certain question or reveal a certain tendency, and the presentation of this information in such a manner as to indicate the answer or the tendency in the clearest possible way.

Thus if the sales manager of a large wholesale business asks for the ratio between the expenditure incurred in advertising in a certain territory during a certain period and the sales made in that territory during the same period, the answering of this question involves the use of the statistical method. Assuming records are kept which make the desired information available, and that the sales for X territory for November are $72,000.00, while the advertising is $6,000.00, there is more than one way of presenting these facts to the sales manager.

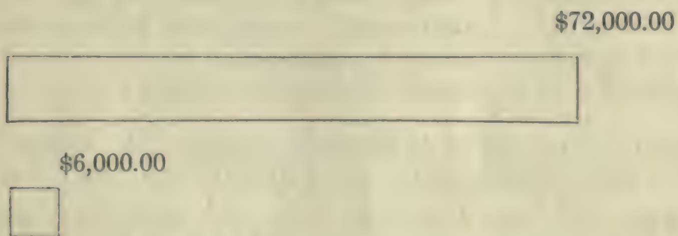
Some possible methods are:

1. Merely a memorandum that $72,000.00 sales were made in X territory during November, with an advertising cost of $6,000.00. This is a simple statement of the facts with no attempt at interpretation. Thus if similar information is furnished for all the sales territories, the significance of the comparisons involved could not be evident without the expenditure of some time and effort in studying the relationships expressed by the figures.

2. To report that net sales for November in X territory were twelve times the advertising cost. This is stating the answer in the form of a *ratio* and is more suggestive than the first answer, because a comparison is indicated.

3. To report that advertising expense is 8 1/3% of net sales. This is not very different from expressing the relation as a ratio, but is preferable because it is easier to understand the meaning of percentages taken on a common basis—in this case net sales.

4. By a chart or graph indicating a comparison between the two items. Such a comparison might be expressed by two bars of equal width, their respective lengths picturing the relation between the two items.



This method of presenting statistical information is known as the *graphic* method, and, as will presently appear, is particularly suitable for the presentation of certain types of information.

Further Illustration of Business Statistics

For the purpose of further illustrating the presentation of statistical data concerning business operations, assume that a certain department store keeps records which furnish the following information regarding the operation of each department:

Gross Sales.
Returns and Allowances.
Net Sales.
Cost of Goods Sold.
Sales Salaries.
Advertising.
Delivery Expense.
General Overhead Expense (allocated to the department).
Net Operating Profit.

Assuming further that this information is made available by months, the information concerning a given department for a year

may be tabulated in a way to show each of these items for each month in the year, thus making it possible to compare different items for the same month, and also the same items for different months. Such a tabulation for Department "A" might appear as on page 485.

There are several comparisons that may be drawn from the information shown by this tabulation, as well as several ways in which such comparisons may be stated. Thus, for example, if it is reported that net sales for January were twenty times advertising expenses, and February thirty-one and one-half times that item, and so on, for each month, comparisons between these two items for each month would be expressed in terms of *ratios*. These ratios could then be compared by months, thus:

RATIO OF NET SALES TO ADVERTISING EXPENSE, "A" DEPARTMENT
For Year Ending December 31, 1919 (By Months)

Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
20	31½	44⅜	25½	26	38	46	24	20	24	26⅕	17¼

In the same manner a comparison could be shown between net sales and any other item with which comparison may seem desirable.

Another method of comparing different items for the same month is by means of percentages. Thus, taking the figure of Net Sales as 100%, it is possible to show other items for any month in terms of the percentage of Net Sales which they represent. This may be illustrated by taking the three items—Net Sales, Cost of Goods Sold, and Gross Profit—and comparing them for the first six months. The percentages would appear as follows:

	Jan.	Feb.	Mar.	Apr.	May	June
Net Sales	100	100	100	100	100	100
Cost of Goods Sold.......	69.3	71.7	73.6	72.9	69.2	69.6
Gross Profit	30.7	28.3	26.4	27.1	30.8	30.4

If the comparison thus established is considered worth showing, every figure in the large table shown above may be expressed as a percentage of Net Sales for the month to which the figure belongs.

Graphic Method Illustrated

Still another and very useful method of presenting statistical information is by means of charts, curves, or graphs, in such a way as to appeal directly to the eye. This may be illustrated first by

(Continued on Page 486)

SALES, OPERATING EXPENSES, AND NET OPERATING PROFIT OF DEPARTMENT "A" FOR THE YEAR ENDING DECEMBER 31, 1919, SHOWN BY MONTHS

	Jan.	Feb.	Mar.	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
Gross Sales	52,500	49,700	45,250	52,600	50,200	48,300	47,500	51,600	53,400	50,500	49,700	57,800	604,050
Returns and Allowances	3,100	2,500	2,100	3,000	3,200	2,800	2,100	3,200	2,800	2,700	2,500	3,200	33,200
Net Sales	49,400	47,200	43,150	49,600	47,000	45,500	45,400	48,400	50,600	47,800	47,200	54,600	570,850
Cost of Goods Sold	34,250	33,800	31,750	34,500	32,500	31,700	32,000	35,200	33,700	34,200	33,600	35,500	400,700
Gross Profit	15,150	13,400	11,400	15,100	14,500	13,800	13,400	13,200	16,900	13,600	13,600	19,100	173,150
Sales Salaries	3,400	3,100	2,500	3,500	3,200	2,900	2,600	3,000	3,500	2,900	2,700	3,700	37,000
Advertising	2,500	1,500	900	1,750	2,100	1,200	950	2,000	2,500	1,900	1,800	3,400	22,500
Delivery Expenses	450	400	420	500	450	430	390	470	450	470	430	550	5,410
General Overhead Expenses	3,100	3,100	3,100	3,100	3,100	3,100	3,100	3,100	3,100	3,100	3,100	3,100	37,200
Total Operating Expenses	9,450	8,100	6,920	8,850	8,850	7,630	7,040	8,570	9,550	8,370	8,030	10,750	102,210
Net Operating Profit	5,700	5,300	4,480	6,250	5,650	6,170	6,360	4,630	7,350	5,230	5,570	8,350	71,040

The graphic harts shown in Illustrations Nos. 48-54 were prepared from the above figures.

SALES, OPERATING EXPENSES, AND NET OPERATING PROFIT OF DEPARTMENT "B" FOR THE YEAR ENDING DECEMBER 31, 1919, SHOWN BY MONTHS

	Jan.	Feb.	Mar.	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
Gross Sales	54,000	51,200	47,100	51,500	51,100	50,500	49,600	54,800	55,500	53,000	51,200	60,100	629,600
Returns and Allowances	2,900	2,700	1,900	3,500	3,300	2,900	2,450	2,950	3,100	2,800	2,600	3,300	34,400
Net Sales	51,100	48,500	45,200	48,000	47,800	47,600	47,150	51,850	52,400	50,200	48,600	56,800	595,200
Cost of Goods Sold	36,000	34,475	32,600	35,000	33,500	33,900	32,000	35,500	36,100	34,100	33,000	38,600	414,775
Gross Profit	15,100	14,025	12,600	13,000	14,300	13,700	15,150	16,350	16,300	16,100	15,600	18,200	180,425
Sales Salaries	3,500	3,300	3,100	3,200	3,250	3,300	3,550	3,600	3,450	3,500	3,480	4,000	41,230
Advertising	2,100	2,000	1,900	2,100	2,100	1,600	1,800	1,500	1,200	1,800	1,700	1,800	21,600
Delivery Expenses	600	500	550	575	550	550	500	600	600	550	500	700	6,775
General Overhead Expenses	3,300	3,300	3,300	3,300	3,300	3,300	3,300	3,300	3,300	3,300	3,300	3,300	39,600
Total Operating Expenses	9,500	9,100	8,850	9,175	9,200	8,750	9,150	9,000	8,550	9,150	8,980	9,800	109,205
Net Operating Profit	5,600	4,925	3,750	3,825	5,100	4,950	6,000	7,350	7,750	6,950	6,620	8,400	71,220

The above figures are to be used in connection with the laboratory material at the close of this chapter.

(Continued from Page 484)

the use of the so-called curve. Several types of curves are employed by statisticians, and for different purposes, but the curves used here for illustration will be of a simple type dealing with the same kind of data.

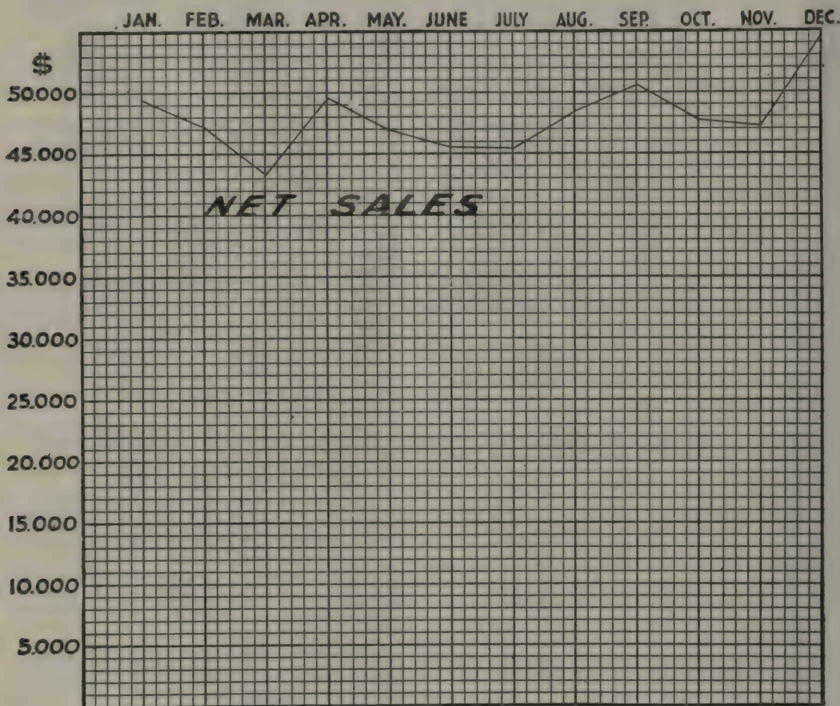


Illustration No. 48—Graphic Chart Showing Net Sales

Illustration No. 48 shows a curve for the net sales of Department "A," plotted by months. An examination of this curve indicates that sales in the department were high during the January and February sales, lower in March, climbing again in April and May, high during August sales, higher still in September, after which they fall off somewhat and reach their peak in the holiday season.

This curve, showing the comparison of sales by months for a single year, at once suggests several other interesting comparisons. Thus it would evidently be interesting to see how the sales of the preceding year, plotted by months, on the same basis and on the same scale, would compare with those of the current year. To show

such a curve, however, it would be necessary to assume additional data. It will, therefore, be omitted, though with a recognition of its value for purposes of comparison.

Comparison of Sales and Cost of Goods Sold

One significant comparison that can be made on the basis of the data above presented is between the net sales by months and the cost of goods sold by months. This is shown by the two curves on Illustration No. 49, both of which are plotted on the same basis and on the same scale.

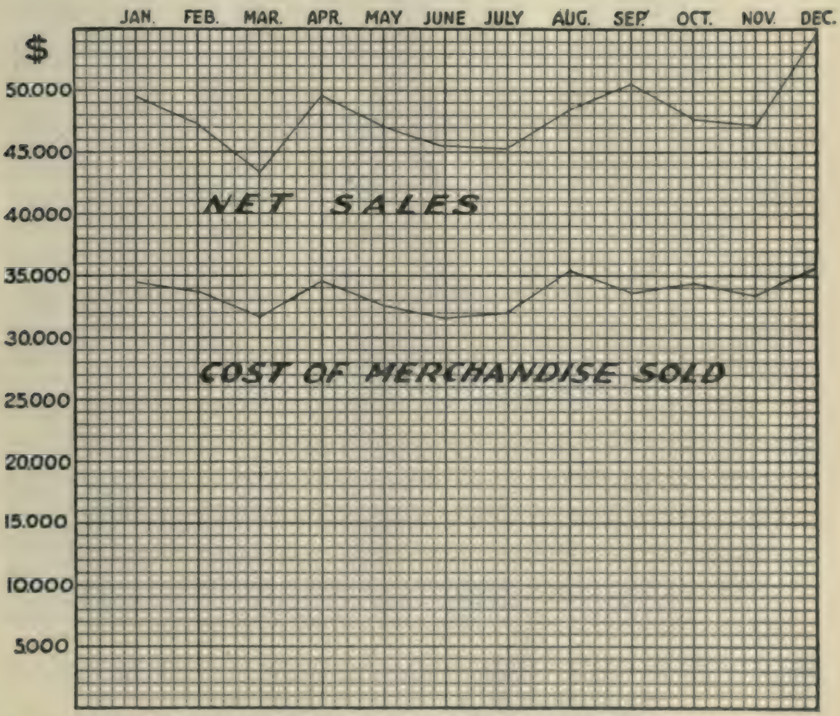


Illustration No. 49—Graphic Chart Showing a Comparison between Net Sales and Cost of Sales

An examination of these two curves shows a tendency toward a fairly close correspondence between the fluctuations of the two curves. However, it is to be seen that the margin between the two items, which measures the gross profit on sales, differs from month to month, not only in amount, but also in its relation to the amount of net sales. Thus it is evident at a glance that a higher percentage

of gross profit was realized in April, September, and December, compared with the other months.

Comparison of Sales and Cost of Advertising

It is altogether probable that the sales manager will desire a comparison between net sales and advertising expense, by months. Such a comparison is presented by the two curves drawn in Illustration No. 50.

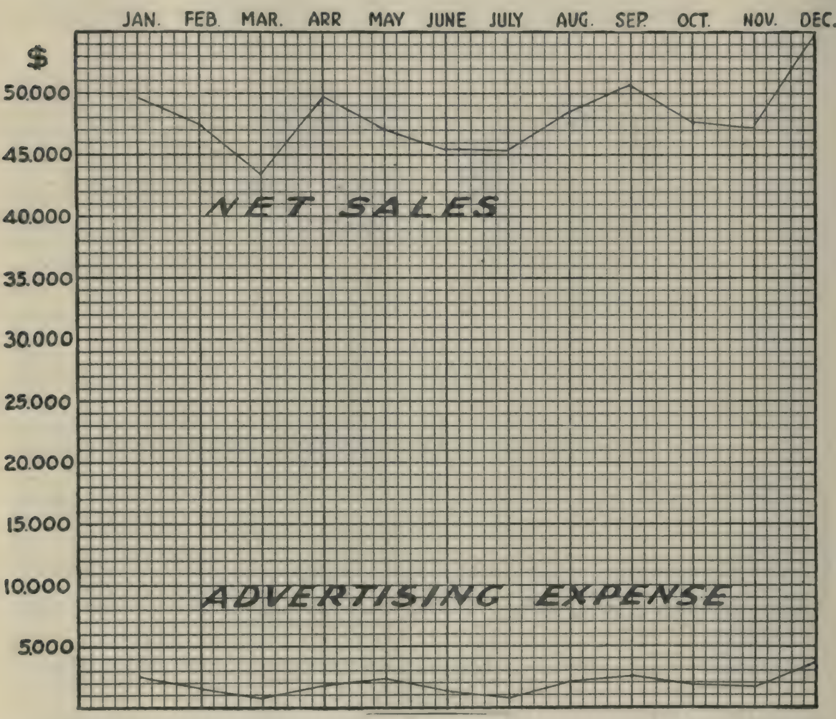


Illustration No. 50—Graphic Chart Showing Comparison between Net Sales and Advertising Expense

It is at least evident from the chart that advertising expense has not been charged to Department "A" on the basis of net sales, since the fluctuations of the two curves are not always in the same direction. In the main, however, the sales have increased as the advertising has increased, which indicates that the advertising has been quite effective. The exception to this uniformity is found in April, when advertising expense is lower than in May, while sales are higher. This is explained probably by the fact that less adver-

tising was needed in April, since the demand is usually heavier during that month.

Comparison of Sales and Operating Expenses

Illustration No. 51 shows a comparison between net sales and total operating expense. Inspection of these two curves shows that increased sales have meant increased operating expense, and *vice versa,* but not always in the same proportion. Any questions that may be raised by a study of this chart will require a reference to the table where the analysis of operating expenses by months is shown, and will probably require an investigation that goes considerably further than that.

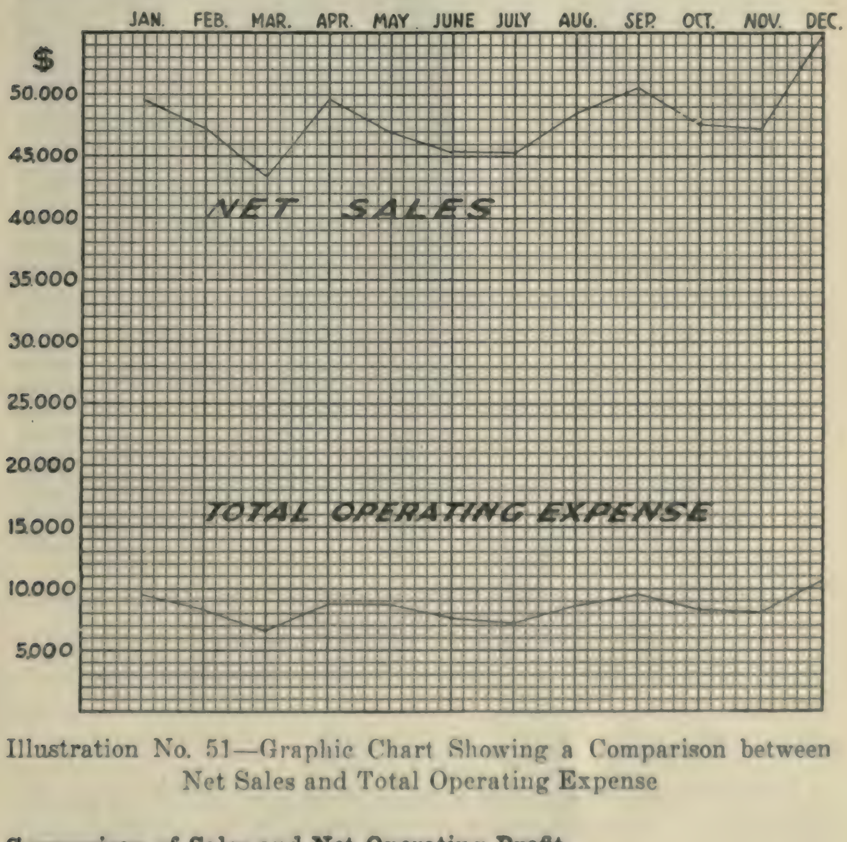


Illustration No. 51—Graphic Chart Showing a Comparison between Net Sales and Total Operating Expense

Comparison of Sales and Net Operating Profit

The comparison between net sales by months and net operating profit by months, as shown in Illustration No. 52, points out the fluctu-

ations in the amount of net profit from month to month to be greater in proportion to the size of the item than are those in the amount of net sales. This, of course, is to be expected, and can be explained by a study of the fluctuations in the items that had to be deducted from net sales each month before the net operating profit could be ascertained.

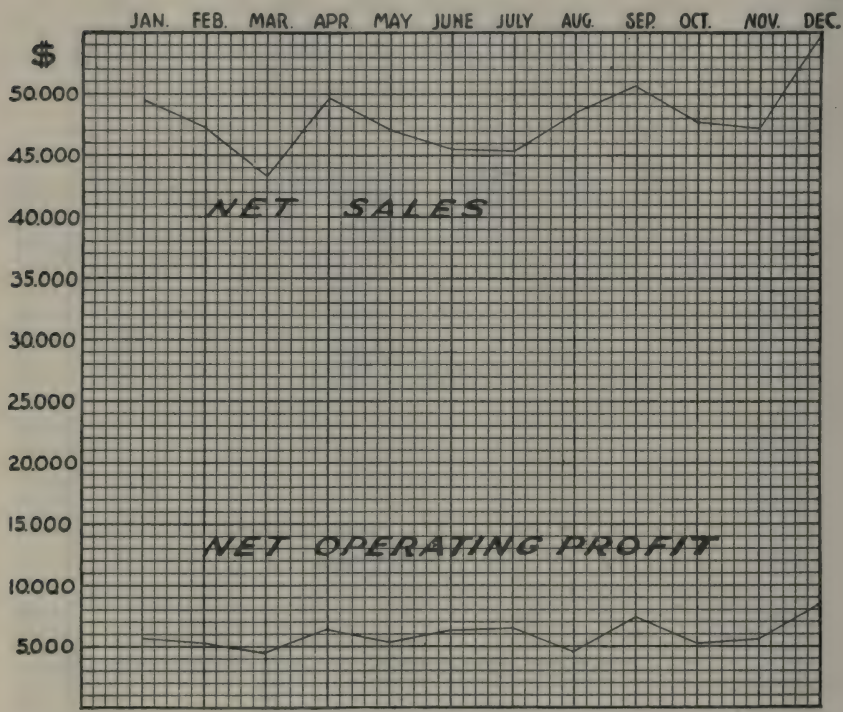


Illustration No. 52—Graphic Chart Showing a Comparison between Net Sales and Net Operating Profit

Different Methods of Graphic Presentation

Another means of showing a comparison between figures graphically is by bars or rectangles of similar width, whose length furnishes the basis for comparison. A case in which this method might well be employed is found in the comparison of total sales for the current year with total sales for the preceding year. Assuming gross

sales for last year to have been $505,500.00, such a comparison is shown in Illustration No. 53 given below.

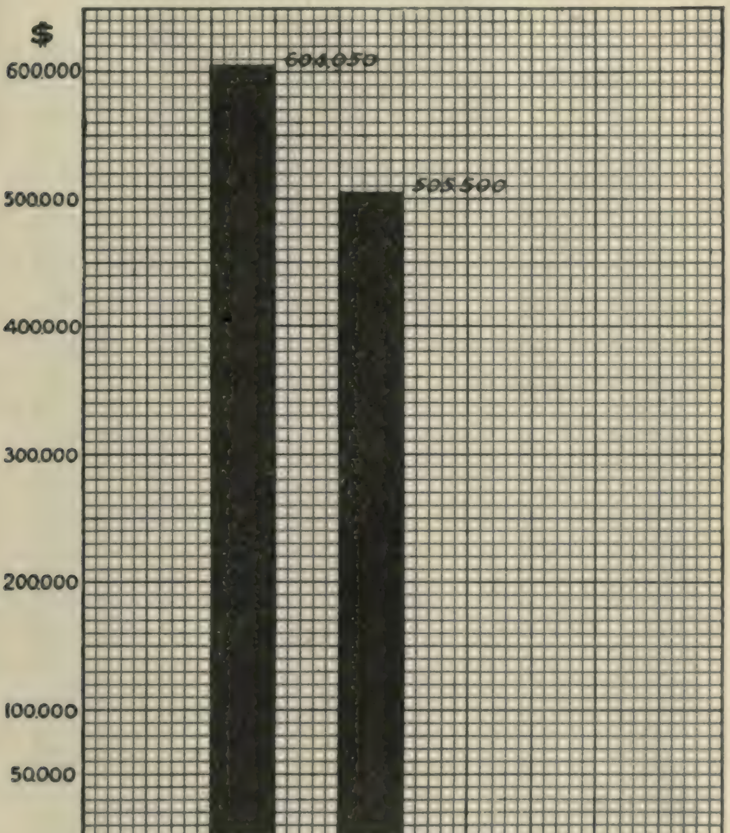


Illustration No. 53—Graphic Chart Showing a Comparison of Sales for Two Years

The rectangle or bar can also be used as a device for showing a comparison of parts with the whole. For example, taking the net sales for January as a whole and drawing to scale a rectangle whose length represents their amount for that month, this rectangle can in turn be divided off into sections representing the deductions to be made from net sales and the net profit remaining after those deductions have been made. Still another basis for comparison is furnished if rectangles are shown for the other months of the year, drawn to the same scale, and divided up in a similar manner. This use of the rectangle in graphic presentation of facts is shown in Illustration No. 54, on page 492.

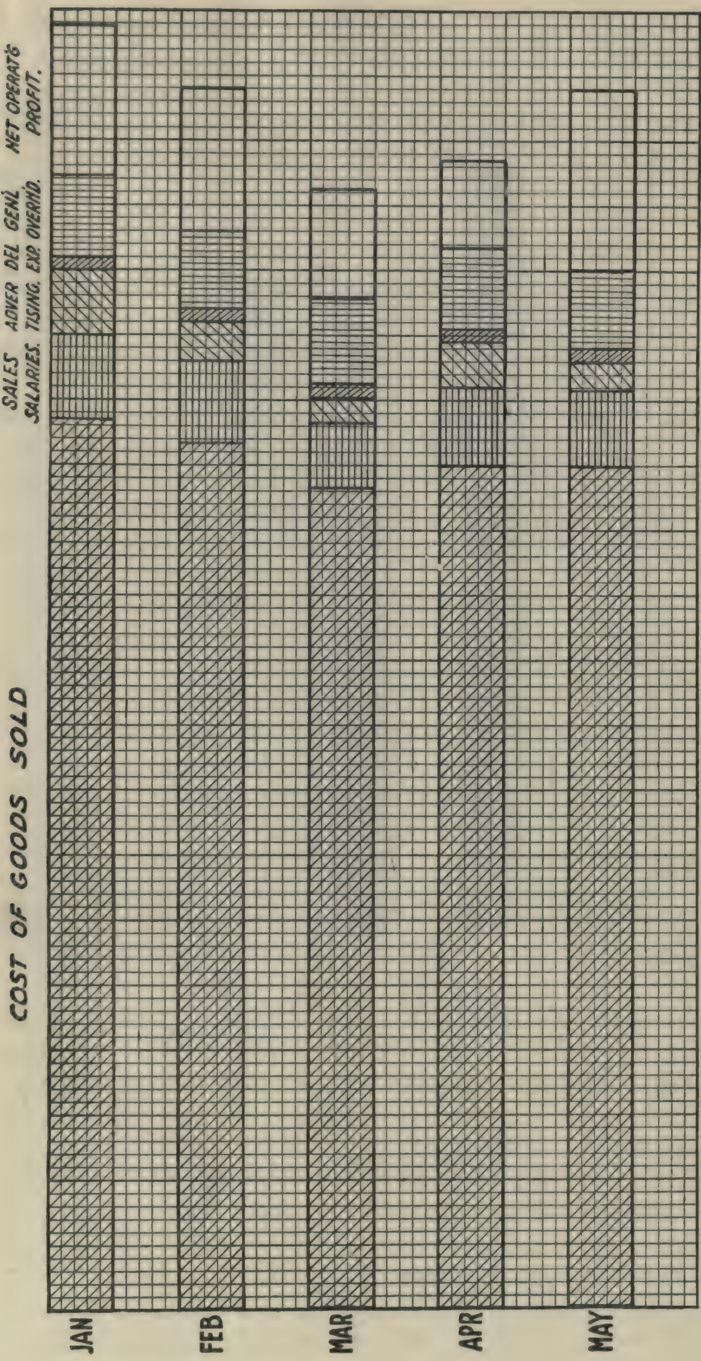


Illustration No. 54—Graphic Chart Showing a Group Comparison

Advantages of the Graphic Method

A few simple illustrations of the graphic method of presenting business statistics have been illustrated and discussed here. Although only a few are given, they are numerous and varied enough to be representative, and they serve to reveal certain advantages, as well as certain weaknesses, of this method of presentation. The more obvious advantages may be listed as follows:

1. The graphic method appeals directly to the eye and is sure to get attention.
2. It brings out comparisons or tendencies in a more striking manner, and renders the facts shown easier of interpretation than does other methods.
3. A busy executive can review a much greater amount of information presented in this form in a given time than if this information were reported in other forms.
4. By the use of curves especially, it is easier to show continuity of certain tendencies over a period of time than it is possible to show by other methods.

Limitations of the Graphic Method

The illustrations of the graphic method shown, have made apparent that this method has certain advantages, but it should also be apparent that there are certain limitations which attach to the use of this method of presenting facts. Some of these are indicated as follows:

1. Only a very limited range of information can be shown on one chart. (Compare the information presented by any one of the seven charts, or, in fact, all of them, with the amount of information given by the single table of figures upon which they are based.)
2. While showing very clearly certain tendencies, the chart does not readily furnish exact information which can be stated in terms of definite figures. In other words, a chart can not be quoted. Graphic presentation of facts is usually not sufficient in itself, but needs to be supplemented by figures. Thus in Illustration No. 54 bars are used in showing comparisons, (1) of totals, and (2) of the parts into which such totals may be divided. A little study of this chart will show that

if each section of each bar were marked to indicate the number of dollars represented by it, and also the percentage which it is of the whole, it would be more enlightening.

3. Considerable training and caution are necessary for the proper use of the graphic method:

(a) On the part of the one submitting the report. A variation in the basis, the scale, or the method of comparison may create a very different impression with regard to a given set of facts, and if not wisely and honestly done, may be very misleading.

(b) On the part of the one reading or interpreting the report. If such reports are drawn in a fashion tending to be misleading, they will mislead more than almost any arrangement of the actual figures. Only one trained in the use and interpretation of statistics would know enough to avoid reading a wrong meaning into charts which are carelessly, ignorantly, or dishonestly prepared.

Summary

In rendering reports to interested parties, the accountant should make use of the most scientific methods of presenting information. This means that the successful accountant must have a knowledge of the statistical method. A very useful way of bringing information to the attention of those to whom it is to be reported is by means of graphs or charts, which present the information pictorially or graphically. There are some very evident advantages connected with this method, but it must be used with caution, as it may be very misleading. Where the graphic method of presentation is employed, it should usually be in connection with statistics tabulated or otherwise reported in a way to show the exact quantities involved, thus retaining the good features of each of the methods of reporting.

QUESTIONS FOR CLASS DISCUSSION

1

The vice-president of the Curry Corporation, who is in charge of sales, requests the accounting department for a statement of the sales and the advertising expense of Department A during the past year. The accounting department determines that the sales for Department A are $100,000.00 and the advertising expense $10,000.00. Explain and illustrate the different ways in which this information may be stated for the benefit of the vice-president.

2

Explain and illustrate what is meant by the statistical method.

3

Illustration No. 48 shows that sales for Department A are the lowest for the year during March. Can you offer any reasons why this is true? Do you think that all departments of the business would show a similar decrease at this time of the year? Would the grocery department, for instance, show as big a decrease in March as the white goods department?

4

Suggest plans which might serve to eliminate such a big decrease in sales during March as is indicated by Illustration No. 48.

5

Illustration No. 49 shows that the sales and the cost of goods sold commence to increase on August 1st, but the cost of goods sold decreases after September 1st, while the sales continue to increase until October 1st. Explain how this is possible.

6

Illustration No. 50 shows that sales decreased during May, while the advertising expense increased. How would you explain this?

7

Illustration No. 51 shows that sales increased much more rapidly than the operating expenses during December. What does this indicate?

8

Illustration No. 52 shows that net operating profit does not always increase when sales increase. Give reasons why this is true.

9

Explain and illustrate three methods which may be employed to show accounting facts graphically.

10

Give the advantages and the disadvantages of the graphic method of presenting accounting statistics.

LABORATORY MATERIAL

Exercise No. 93

On sheets of white paper ruled similar to Illustration No. 48 (paper with this ruling may be purchased at any stationery store), prepare from the figures given for Department B, on page 485, curves to indicate the following:

1. Net sales.
2. Comparison of net sales and cost of goods sold.
3. Comparison of net sales and total operating expenses.
4. Comparison of net sales and advertising expenses.
5. Comparison of net sales and net operating profit.

The discussion and illustrations on pages 486 to 492 will be of assistance in preparing this exercise.

Exercise No. 94

Prepare bars showing the proportion of sales and sales expense for the two fiscal periods in Practice Set No. 3. See explanation and illustration on page 483.

CHAPTER XXXVI

SINGLE ENTRY

Methods of Bookkeeping

It has been emphasized in previous chapters that in making a record of transactions an equality of debits and credits should be maintained. When this method is followed it results in what is known as double entry bookkeeping. It is based on the principle that each transaction involves an exchange of equal values, and that the record should show the value of the property or services received and of the property or services given in return in each transaction.

Sometimes another method of bookkeeping is employed in which no attempt is made to maintain an equality of debits and credits. Under this method only part of the effect of a transaction on the financial condition of a business may be shown in the accounting records. For instance, $75.00 may be paid for one month's service of a stenographer. The payment of the $75.00 of cash may be recorded by a credit to cash, but the receipt of the services is not shown. So it is with other transactions—the debits may be recorded and the credit ignored, or vice versa. This method of recording transactions is known as *single entry* bookkeeping.

Single Entry Bookkeeping

As indicated by the preceding paragraph, single entry bookkeeping is a method of bookkeeping by which only part of the debits and credits resulting from the business transactions performed are recorded. There is no uniform practice as to what should and what should not be recorded when single entry is used. Usually there are certain facts which the owner of the business thinks of particular importance and these are recorded while the remainder are omitted.

In nearly all cases a record is kept of the amount due from customers, the amount due to creditors, and of the cash receipts and disbursements. Some authors even go so far as to define single entry as a method of bookkeeping which provides a record of these and of nothing else. In practice, however, all kinds of variations

and modifications may be found. Often a single entry system may be established which provides a record of only the items mentioned, but as the business expands additional information will be desired and the records will be modified to provide it. More and more information may be desired with consequent modifications of the bookkeeping records until probably a double entry system will be developed.

It can be seen, therefore, that it is impossible to say arbitrarily of what a single entry system may consist. It is more nearly correct to say that whenever there is a system of records which is not kept by double entry that it is a single entry system. Single entry was probably originally so called on the assumption that only one entry—that is, a debit or a credit—was made in the case of each transaction. This was never strictly true, for if a customer paid his account, cash was debited and the Customer's account was credited, and a similar procedure was followed in the case of other transactions. It is still less true at present under the modifications which have taken place. Any account kept in the case of double entry may be kept in the case of single entry. Consequently, in the case of many transactions equal debits and credits are recorded. However, so long as equal debits and credits are not recorded for all transactions, it is not *double* entry, and may be conveniently termed *single* or, as some writers suggest as more appropriate, *simple* entry.

Records Required for Single Entry

Any record used with the double entry method may be used with the single entry method. In the very simplest type of single entry, however, usually three records are required: the journal, the cash book and the ledger.

If a record is kept with only creditors, customers and cash, the debits to the Customers' accounts and the credits to the Creditors' accounts would be from the journal. The cash received from customers is recorded on the debit side of the cash book from which the credit to the Customer's account is made. The cash paid to creditors is recorded on the credit side of the cash book from which the debit to the Creditor's account is made. The other items in the cash book are not posted.

It is not deemed worth while to illustrate the books used in single entry. It is not likely that the student will ever be required to keep a set of single entry books. When they are used at present

it is almost invariably because a bookkeeper is not employed and the books are kept by some one who is ignorant of bookkeeping methods, but has had to develop some means of obtaining certain necessary information. If a bookkeeper is employed, it is almost always for the purpose of installing a double entry system. It is of little importance, therefore, to understand the details of operating a single entry system. The thing of primary importance is to know how to change a single entry system to a double entry system, and this is explained later in this chapter. Even if it were deemed worth while, it is impossible to give an illustration of a single entry system which would be more than merely suggestive, for single entry systems vary widely and are not governed in their operation by any well-established principles as is the double entry system.

Proving the Accuracy of Single Entry Records

There is no satisfactory way of proving the accuracy of single entry records. Since there is no attempt to maintain an equality of debits and credits, a trial balance can not be made. The only proof of work possible is the checking of the ledger record with the record in the books of original entry. As a consequence, inaccuracies may occur which will not be detected. Of course, if errors occur in connection with the debiting or crediting of the personal accounts, these may be detected at the time of settlement. If, however, the error is in favor of the customer or creditor, he may not report it and it may not be discovered.

Determining Profit and Loss Under Single Entry

Since by the single entry method there is often no record whatever kept of the income and expenses of the business, and in no case is there a complete record, it is impossible to make a Statement of Profit and Loss. Although a Statement of Profit and Loss showing the results of the operations of the period is not possible, it is possible to determine the net profit or loss for a period by a comparison of a Balance Sheet made at the beginning of the period and a Balance Sheet made at the end of the period.

Determination of Profit and Loss by Means of the Balance Sheet

Some of the assets and liabilities appear on the ledger. The remaining assets can be obtained by means of an inventory and appraisal. The liabilities that do not appear on the ledger can

usually be obtained by inspecting the memorandum records, the unpaid invoices, etc. After the assets and liabilities, including the accrued income, accrued expenses and deferred charges, are obtained, a Balance Sheet can be prepared which will give the net worth or proprietorship. If such a Balance Sheet is made both at the beginning and at the end of the fiscal period, a comparison of the net worth as shown by these Balance Sheets will show the profit or loss for the period, providing no additional capital has been added during the period or no withdrawals have been made.

To illustrate this method of determining profit or less, it may be assumed that the financial condition of P. C. Dodge on December 31, 1919, and December 31, 1920, is represented by the following condensed Balance Sheets:

P. C. DODGE

Balance Sheet, December 31, 1919

Current Assets	4,200 00	Current Liabilities	1,900 00
Deferred Charges	300 00	Proprietorship	5,000 00
Fixed Assets	2,400 00		
	6,900 00		6,900 00

P. C. DODGE

Balance Sheet, December 31, 1920

Current Assets	5,800 00	Current Liabilities	2,120 00
Deferred Charges	340 00	Proprietorship	6,300 00
Fixed Assets	2,280 00		
	8,420 00		8,420 00

It will be seen that the proprietorship of Dodge has increased $1,300.00 during the year. Consequently, if no additional investment has been made during the year and no withdrawals have been made, this increase of $1.300.00 in proprietorship shows the net profit for the year. It can be seen readily that if an additional investment has been made during the year it must be subtracted from the increase of proprietorship and that any withdrawals must be added before the net profit is obtained.

Although the net profit for the fiscal period may be obtained by a comparison of Balance Sheets, no analysis of expenses and income is provided; consequently it is difficult to judge as to the efficiency of past operations or to plan future operations. Such an analysis can be obtained only by a properly designed system of double entry records.

Comparison of Single Entry and Double Entry

Single entry as usually practiced is simple, and since a record is made of only part of the debits and credits which result from the transactions performed, the posting is much less than in double entry. No difficult analysis of transactions is involved and it is somewhat easier to understand by those who are untrained in accounting practice. This brevity and simplicity, however, are secured at the expense of the analysis and information which it is the primary function of the accounting system to provide. Double entry provides a classified record of every transaction, a proof of the accuracy of the record, and a full statement of the sources of the profits and of the causes of the expenses, and these can not be obtained from single entry records.

Consequently, single entry is employed very rarely at present by commercial firms. When it is employed by such firms, it is where, as was stated before, the smallness of the firm makes a bookkeeper unnecessary and some one untrained in accounting designs and keeps the records. In special cases single entry records may serve fairly satisfactorily. Professional men, such as doctors and lawyers, often keep their records by single entry. If, however, their expenses are of material size, the additional information obtained from double entry records is worth more than the extra labor involved.

Changing from Single Entry to Double Entry

When the accountant or bookkeeper finds a system of records kept by single entry, it is necessary for him to be able to change it to double entry. The first step in this process is the preparation of a Balance Sheet showing the assets, liabilities and proprietorship of the business. The next step is to make the entries which are necessary so the records may show the same information that is given by the Balance Sheet. If a new set of records is to be opened, this is comparatively easy. It is only necessary to make a compound journal entry which records the assets, liabilities and proprietorship as shown on the Balance Sheet and to post these items to the appropriate accounts. If, however, the same records are to be used, some of the assets and liabilities shown on the Balance Sheet will be already in the ledger. It is necessary to check these items which are already recorded in the ledger and to post only the additional items which are shown on the Balance Sheet, but not in the ledger.

To illustrate the method of making the entries in the latter case, it may be assumed that James Brown has been keeping a system of single entry books by which a record is maintained with cash, accounts receivable and accounts payable. The Balance Sheet of Brown on December 31, 1920, is as follows:

JAMES BROWN

Balance Sheet, December 31, 1920

Cash	520	00	Notes Payable	2,864	00
Notes Receivable	86	00	Accounts Payable	2,978	40
Accounts Receivable	3,240	00	James Brown, Prop.	7,792	40
Merchandise Inventory	4,156	80			
Office Furniture	482	00			
Building	2,150	00			
Land	3,000	00			
	13,634	80		13,634	80

The journal entry necessary to open the double entry books of Brown is as follows:

December 31, 1919

	√	Cash	520	00		
		Notes Receivable	86	00		
	√	Accounts Receivable	3,240	00		
		Merchandise Inventory	4,156	80		
		Office Furniture	482	00		
		Building	2,150	00		
		Land	3,000	00		
		Notes Payable			2,864	00
	√	Accounts Payable			2,978	40
		James Brown, Proprietor			7,792	40
		To record the assets, liabilities, and proprietorship of James Brown on December 31, 1919, on which date his records are changed from single entry to double entry.				

It will be noticed that the entries for cash, accounts receivable and accounts payable are checked so they will not be posted. There are already accounts in the ledger with these items. No doubt there are separate accounts with customers and creditors maintained in the ledger. Accounts receivable and payable are shown as totals on the Balance Sheet and in the opening entry for the sake of brevity. If the separate accounts are shown in the opening entry, each of these will have to be checked and not posted. When the opening entries are posted, the ledger should be in balance and this should be proven by a Trial Balance.

Method of Keeping Statistical Records

Although it is important that a double entry record be made of the transactions recorded in the ledger, in many businesses there are supplementary records kept which are not kept by double entry. In fact, some of the most important information used in the management of a business may not come from double entry records.

There are many illustrations of these supplementary statistical records. In a store where there are several sales clerks employed, it is desirable to compare their efficiency in terms of sales. Consequently, a record is kept of their daily, weekly and monthly sales, and a report made, sometimes weekly and sometimes monthly, which shows their sales in comparative form. In the same manner a record may be kept of sales by departments, or of the sales of different commodities. Further analyses may be made to show sales by territories, by terms of sale, by method of delivery, etc. These analyses are usually made by means of supplementary records and are not shown in the ledger accounts. Often one of these analyses, such as sales by departments, is shown in the accounts, while the others are shown by the supplementary records.

The use of these supplementary records is suggested at this time in order that the student may not make the error of thinking that it is only from the double entry accounts that the information used as a basis of business management is obtained.

QUESTIONS FOR CLASS DISCUSSION

1

Explain the distinction between single entry and double entry bookkeeping.

2

Can a definite description of single entry bookkeeping be given? Why?

3

What records may be used in connection with single entry system?

4

Can a Trial Balance of a single entry system of bookkeeping be prepared? Why?

5

Can the correctness of such a system be proven in any other manner?

6

Explain and illustrate how profit and loss may be determined when records are kept by single entry.

7

Explain the advantages of double entry over single entry.

8

Explain and illustrate the method of changing single entry to double entry.

9

A. B. Smith has been keeping his records by single entry. He maintains accounts in his ledger with cash, customers and creditors. He desires to change his records from single entry to double entry, but intends to use the same ledger as before. Explain what would be necessary in making the entries to change his records from single entry to double entry in order to avoid a duplication of the accounts with cash, customers and creditors.

10

Explain how single entry records may be of value in gathering information for statistical purposes.

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C

D

LIST OF ILLUSTRATIONS